FEDERAL DEPOSIT INSURANCE CORPORATION

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ADVISORY COMMITTEE ON COMMUNITY BANKING

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MEETING

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THURSDAY,
MAY 2, 2024

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The Advisory Committee convened at 9:00 a.m. in the Federal Deposit Insurance Corporation Board Room at 550 17th Street NW, Washington, D.C., Martin J. Gruenberg, Chairman, presiding.

PRESENT:

THOMAS BATES, President & CEO, Legends Bank, Clarksville, Tennessee
MARLENE BARKHEIMER, President & CEO, Farmers State Bank, West Salem, Ohio
HEIDI BROWN, Executive Vice President, Citizens State Bank, Sheldon, Iowa
CAROLYN CROCKETT, President & Chief Credit Officer, First Security Bank of Nevada, Las Vegas, Nevada
MICHAEL CULHANE, President & CEO, North Cambridge Co-Operative Bank, Cambridge, Massachusetts
LLOYD DEVAUX, President & CEO, Sunstate Bank, Miami, Florida
ANITA DRENTLAW, President & CEO, New Market Bank, New Market, Minnesota
SUSAN HORTON, President, CEO, & Chairman of the Board,
Wheatland Bank, Spokane, Washington

WARREN HUANG, General Counsel, Amerasia Bank, Flushing, New York
ROBERT JAMES II, Executive Vice President, Carver State Bank, Savannah, Georgia
TREY MAUST, Executive Chairman, Lewis & Clark Bank, Oregon City, Oregon
DOMINIK MJARTAN, President & CEO, OPTUS Bank, Columbia, South Carolina
NORMAN PLUMSTEAD, President & CEO, Honor Bank, Honor, Michigan
KIM REIGELSBERGER, President, Preferred Bank, Rothville, Missouri
TROY RICHARDS, President, Guaranty Bank & Trust Company, Delhi, Louisiana
LILLOUS ANN SHOEMAKER, President, Magnolia State Bank, Bay Springs, Mississippi

ALSO PRESENT:

MARTIN J. GRUENBERG, Chairman, Federal Deposit Insurance Corporation
TRAVIS HILL, Vice Chairman, Federal Deposit Insurance Corporation
NIKITA PEARSON, Designated Federal Officer, Deputy to the Chairman for External Affairs and Director, Office of Minority and Women Inclusion
KATHY KALSER, Assistant Director, Division of Insurance and Research
KRISHNA PATEL, Section Chief, Division of Insurance and Research
JAMES PRESLEY-NELSON, Acting Section Chief, Division of Insurance and Research
CAMILLE SCHMIDT, Section Chief, Division of Risk Management Supervision
JAY SNIPES, Section Chief, Office of Minority and Women Inclusion
BETTY RUDOLPH, National Director, Office of Minority and Community Development Banking
THOMAS LYONS, Associate Director, Division of Risk Management Supervision
LISA ARQUETTE, Deputy Director, Division of Risk

Management Supervision
MICHAEL BENARDO, Associate Director, Division of Risk Management Supervision
LLOYD MCINTYRE, Examination Specialist (Fraud), Division of Risk Management Supervision
MARK PEARCE, Director, Division of Depositor and Consumer Protection
LUKE BROWN, Associate Director, Division of Depositor and Consumer Protection
MERON WONDWOSEN, Assistant Director, Division of Depositor and Consumer Protection
EDWARD HOF, Senior Policy Analyst, Division of Depositor and Consumer Protection
CHANTAL HERNANDEZ, Counsel, Legal Division

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Adjourn

P-R-O-C-E-E-D-I-N-G-S

9:01 a.m.

CHAIRMAN GRUENBERG: Let me welcome you all to this meeting of the FDIC's Advisory Committee on Community Banking. I can't tell you how much we appreciate your willingness to serve on this Committee.

It's been a source of enormous value to the FDIC to gain direct access to your insights, really representing a cross section of community bankers from around the country.

It's really as efficient a way as I know to get direct feedback from local communities across the country as to what's happening in the banking system. So, thank you very much for your participation.

Before we get started, if I may, I'd like to welcome a number of new members who have just joined the Committee.

Marlene Barkheimer, CEO of Farmers State Bank in West Salem, Ohio. I'd say, if you'd

raise your hand just so I can spot you. Thank you.

And, Heidi Brown, Executive Vice President of Citizens State Bank in Sheldon, Iowa. Carolyn Crockett, President and Chief Credit Officer, First Security Bank of Nevada. They put them on either side of me, so I have less trouble finding them.

Lloyd DeVaux, CEO of Sunstate Bank in Miami. And, Norman Plumstead, President and CEO of Honor Bank in Honor, Michigan.

Thank you all and welcome. We have a full agenda today. I won't go through it.

But, I particularly value, and I think, it's the highlight of every meeting when we sort of go around and ask each of you to give us your take in response to different issues that you're seeing in your local communities and at your institutions. So, I particularly look forward to that.

And, with that brief introduction, if

I may, I'm delighted that our Vice Chairman, Travis Hill, is able to be here this morning. And, Travis, if you'd like to?

VICE CHAIRMAN HILL: Well, I'll just add, I just also want to thank everyone for being here.

Also, I very much appreciate the perspectives that everyone has to share. And, I look forward to the discussion this morning and this afternoon too.

CHAIRMAN GRUENBERG: Great. Thank you. So, if I may, I'd like to now turn the program over to Nikita Pearson, who is the Designated Federal Officer for this Advisory Committee.

And, Nikita, of course, is Deputy to the Chairman for External Affairs and will serve as our moderator for today's meeting.

MS. PEARSON: Thank you, Chairman. Good morning and welcome everyone. Before we start today's agenda, I have a couple of

housekeeping remarks.

I'll start with reading the Sunshine Act. While we don't have three Members of the Board present today, we may at some point have three Members. And, in that case, in abundance of caution, I will read the Sunshine Act.

The Government in the Sunshine Act imposes notice and access requirements whenever a quorum of the FDIC's Board of Directors meets to conduct or determine Agency business.

This meeting is not held for such purposes and does not constitute a meeting under the Act.

The Board Members present will only engage in general or preliminary discussions that do not relate to specific proposals for action pending before the FDIC.

Any specific issues for official Board resolution will remain open for full consideration by the Board following the conclusion of the meeting. If you have any

questions, we'll be glad to answer them.

All right. The second housekeeping item. We have -- we would like to recognize a special member of the audience today, Jorge Huerta. Jorge, would you please stand?

Jorge is a Senior Business Administration student at Marymount University in Arlington, Virginia.

Jorge will graduate with his Bachelor's Degree next week, on May 10th. And, he is eager to continue his academic journey towards a Master's Degree.

As a cofounder of Marymount University's Entrepreneurship Club, Jorge has cultivated a passion for innovation and business development.

He is a first-generation college student, which fuels his drive for success. Jorge's participation as a -- is a part of the FDIC's Banking Career Immersion Project.

This effort seeks to raise awareness

about career opportunities in financial services with increased outreach to groups with less than expected representation within our workforce.

I would like to congratulate Jorge on his upcoming graduation and welcome him to today's meeting. Thank you for joining us.

We would now like to welcome from the Division of Insurance and Research and Division of Risk Management Supervision some of our team members to come to the table.

They will spend the next two hours focusing on two primary objectives. First, they will provide a briefing on the FDIC's upcoming 2024 Risk Review, including economic updates and recent banking trends.

During this segment, you can expect to gain some perspective on what examiners are seeing on the ground across the country.

And second, they will seek your perspective by asking you to respond to questions that we shared with you in advance prior to the

meeting.

We value your responses to these questions, because it provides us with firsthand knowledge on the interest rate environment, deposit changes, credit portfolios, and the current lending environment.

For your awareness, we plan to take a short break about 10:00 a.m., or following the market discussion. Whichever one comes first. And, we plan to wrap up the discussion about 11:00 a.m.

I will now turn the meeting over to Assistant Director Kathy Kalser, Acting Section Chief James Presley-Nelson, Section Chief Krishna Patel, and Section Chief Camille Schmidt. The show is yours.

MS. PATEL: Thanks Nikita. Well, let's see, our presentation will focus mostly on risks that we're seeing to the banking industry.

And, by way of sort of motivating that discussion, I want to introduce you to our annual

risk review.

Our annual risk review is an annual publication that we -- that we put out every year to discuss the main risks and trends that we see in the banking system over the previous year.

So, and the report is structured along a handful of themes. It starts off with sort of an economic and banking, or -- and financial market backdrop.

It talks about market risks. Market risks include funding developments -- developments in deposit trends and net interest margins.

We also talk about credit risks. Credit risks to the main portfolios in the banking sector, including agriculture, energy, commercial real estate, residential real estate, consumer lending, small business lending, and the like.

Finally, the report talks about other risks. Other risks include -- there are many

risks in the banking industry.

But, the ones that we've highlighted -- highlight, include risks in the crypto asset markets, risks from climate-related financial risks, and then finally operational risks.

So, we will touch upon those in today's discussion. And, we will sort of give plenty of opportunities to hear your thoughts throughout the presentation.

I will first talk about the economic and financial market backdrop to sort of -- as sort of a description of the banking environment overall.

Then, I will turn to my colleagues to discuss market risks. We'll take a brief break as Nikita mentioned. And then, we'll come back, and we'll talk about credit risks and then some of the other risks that we haven't touched upon already.

Regarding economic conditions, things have been better than expected. Last year we

were thinking about a recession.

This year we were expecting a recession, recession probabilities were very high. But, so far, the economy remained relatively resilient.

Economic growth was fairly widespread throughout last year, despite the challenges of higher inflation and higher interest rates, as many of you have been dealing with.

The economic conditions have slowed quite a bit in first quarter of this year. Economic growth slowed to 1.6 percent, which is a significant slowdown from around 3 percent that we experienced in the latter half of last year. Three percent is pretty good. It's above trend.

So, we had a slow down this year. This was expected. And, still better than expected. You know, we didn't have a recession.

But, you know, something to kind of look into as the environment has shifted a little bit from the strong pace of last year. A slowdown

is reflecting the effects of higher interest rates.

And, this is sort of the intended effect of the higher interest rate, to sort of slow things down. To make the labor market less tight. And, to drive inflation that's sort of, that's sort of the, more of a sustainable level.

So, where we're seeing slow down here is in consumer spending. Consumer spending still continues to grow at a reasonable rate, but maybe a little bit slower.

Business investment is expected to slow this year. And, of course, residential investment, even though it sort of did continue to contribute to economic growth, again, slow due to higher interest rates.

And so, sort of a more of across the board slowdown in the main components of the economy, is just sort of what was expected.

In terms of interest rates, which is in the next slide, this is another -- a big area

to sort of -- a big area that's influencing trends for the banking sector.

The last year we talked, you know, we met in the fall when interest rates were rising. The longer-term interest rates were rising faster, even as short-term interest rates held steady.

You know, since we met last year, longer-term interest rates have declined, but, still remain elevated. And, yield curve remains inverted.

So, you know, this has been sort of an issue for the banking system for more -- for a couple of years now.

And, it's worth noting that the yield curve inversion, you know, we've been through periods of higher interest rates before, but the yield curve being inverted, and the degree of the inversion, is a thing that stands out this time around.

And so, even as we're thinking about,

you know, even as short-term rates have stabilized, even thinking about potential rate cuts maybe later this year, you know, there's some, this continues to be a challenge because, not only does the yield curve remain inverted for longer, but also we might be experiencing higher-for-longer interest rates as inflation remains high and the Federal Reserve, you know, remains pat on the current stance of monetary policy.

So, the interest rate future is sort of what has been driving both economic conditions and banking conditions. And, we will talk about that.

Yeah, I'm going to turn it over to James to talk about sort of the banking conditions and how that's evolving.

MR. PRESLEY-NELSON: Thank you, Krishna. So, my next few slides are going to cover all 4,140 community banks at the year end.

So, we're looking at full year 2023 financials compared to full year 2022 financials.

The community banks in the country have $2.7 trillion in assets combined, $1.9 trillion in loans, and $2.2 trillion in deposits.

So, full year net income for community banks was $26.6 billion. That was down $2 billion, or 6.8 percent, as you can see on the left.

Community banks benefitted from a better interest rate environment in 2023, especially at the beginning. They were booking a lot of interest income gains.

But, they were also seeing higher costs as well. But, ultimately benefitted net interest income, up $2.7 billion, or 3.4 percent.

Higher provisions were a drag on income in 2023. We saw a significant amount of loan growth, which we'll see on the next slide.

So, that also added to provisions. Some small amount of loan deterioration as well. Noninterest expense was up for community banks in the full year of 2023.

There was a lot of individual write-in items that we can't really parse through on the Call Report too well. Some community banks are also part of larger banking organizations that were subject to the FDIC special assessment.

But, we also had higher salary expenses in 2023 than we did in 2022. Those were the main items flowing through net income in 2023.

On the next slide, I'll walk you through what was really a bright spot for community banks compared to non-community banks in 2023, and that was loan growth.

Loan growth was up 7.8 percent. The blue bar shows the annual change. The gold bar shows the quarterly change from third to fourth quarter.

So, the community banks saw loans grow 7.8 percent. Non-community banks had less than 1 percent growth over the same time frame. So, really a strong loan growth year, it was driven

-- from left to right, we can see different loan categories. It's stacked by the largest dollar driver annually. Non-farm non-res grew the most, 7.2 percent.

It was a really, really strong year for one-to-four family at 10 percent. C&I is also very strong.

So, if we can move to the next chart, I'll talk a little bit about deposit growth before handing things off to my colleagues.

Here we can see the merger-adjusted community bank deposit growth in gold and deposit growth in the industry as a whole in the hash bar. And, you see, the industry was losing deposits for six consecutive quarters throughout 2022 and 2023 and, that reversed at the end of the year. During that same period, many of those -- many of those quarters, community banks actually saw deposit growth.

And, Camille will touch a little bit more on exactly what deposits were growing in her

section.

MS. SCHMIDT: All right. Thanks, James. And, we'll get into the market risks section of the risk review.

And, in general, I'm starting out with liquidity. Like James was starting to allude to, that deposits at community banks increased in 2023. But, loan growth outpaced that deposit growth, which overall reduced liquidity.

So, while we saw a large drawdown of cash back in 2022, 2023 saw a reduction in liquid securities and an increase in those cash balances.

So, similar to the industry as a whole, community banks pledged a significant amount of bonds to secure additional borrowings, borrowing lines. And, they sold bonds in 2023.

So, relative to total assets, as you can see here, community banks are now at pre-pandemic levels of liquidity. Excess liquidity has more or less left the banking system for

community banks and for the industry as a whole.

If we move to the next slide, I'm going to talk about unrealized losses for the industry. They're significantly -- they're still significant, but show signs of improvement.

Long-term rates were in about the same position at the end of fourth quarter 2022 as they were in fourth quarter 2023. But, overall, unrealized losses fell 23 percent.

The severity of the losses, relative to the book value of securities, also declined in 2023. We're seeing that a notable number of banks started realizing losses on their bond portfolio in 2023, generally in small amounts relative to capital.

In aggregate, both community banks and the industry reduced their bond portfolio amortized costs in 2023, likely through sales of bonds.

Long-term rates, as you know, started rising in early first quarter of this year. And,

they've risen ever since.

And, even with mitigation or sales of bonds, unrealized losses will likely stay elevated in the near future. And, I just checked, you know, early Call Report filers this morning, and I think, we'll see about the same amount as we did last quarter.

Shifting to the slide on wholesale funding. Overall, wholesale funding continued to rise in 2023. And, it rose above pre-pandemic levels relative to total assets.

Wholesale funding growth for community banks was led by an increase in other borrowings. That's likely the Bank Term Funding Program. It also increased through broker deposits.

The Federal Home Loan Bank borrowings grew. But, at a much slower pace than they did in 2022.

So, while wholesale funding is rising, community banks get most of their funding from

public funds or government deposits. And, we've talked about that in the past.

Public funds make up about half of community banks wholesale funding. And, they bring their own, you know, unique liquidity risk management issues and concerns.

And, you can see on this chart that public funds have risen steadily for community banks over the last decade.

Shifting to the last slide that I want to talk about, this is probably what we'll talk a lot about. This was a big subject of conversation yesterday when we met with some MDI subcommittee members.

But, high interest rates in 2023 have driven many depositors to seek higher yields on their deposits. So, banks have reported shifts from lower-yielding DDA deposit accounts, such as, you know, your transaction and savings accounts, to higher-yielding time deposits.

In 2023, funding costs increased

faster than yields, reversing most, but not all, of the large gains in net interest margins that occurred in 2022. Most of that reversal occurred in the early half of 2023 as NIM compression in the second half of 2023 and the increases in yields really began to converge.

But, I do think we'll see continued NIM compression. We're certainly seeing that again in early Call Report filings for first quarter.

So, while aggregate net interest margins are higher than they were at the beginning of rate hikes, individual bank experiences have varied.

Our group's analysis showed a notable portion of banks that still have lower net interest margins than they did in 2021. So, while net interest margins remain above pandemic lows, a number of institutions are still struggling with funding costs eating into margins.

So, with that, we'll move into some

questions for you. Again, we've put a few up here. You don't have to stick to those exact questions.

But, I think, they have -- will surely help spur you into talking about what you're seeing at your banks, what you're experiencing from deposit competition and how you're managing your securities portfolio.

Is there anyone that wants to begin the discussion today?

MEMBER JAMES: Good morning, Robert James, II, Carver State Bank, Savannah, Georgia. And also, I'm President of our holding company and we also own Alamerica Bank, which is in Birmingham, Alabama. Mr. Chairman, great to see you as always.

Our -- right after the Silicon Valley Bank failure, we were pleasantly surprised that our deposit base was pretty quiet regarding, you know, rates.

That has now changed. You know, our

depositors were a little slow to the party. But, they are demanding much, much higher rates, which is, you know, starting to compress NIM.

Our audit, our 2023 audited financial statement, you know, our CPA firm noted that we experienced a compression in NIM.

We still, we did better than the other banks that they audit in the region. But, they said that they could, you know, start to notice it.

And so, you know, we're having to respond to those particularly larger customers, larger depositors who are demanding higher rates on their deposits. It's very competitive.

The other quick point I'll make is that we are also, because we're a minority depository institution and a CDFI, we've been making a very strong effort to encourage large corporations or, you know, foundations of the larger institutional investors to invest in our mission and, to take a mission rate on their

deposits. And, we're finding that much, much more challenging.

So, you know, the large corporations now, they want us to do the mission. They want us to serve the under-served community.

They want us to provide them with impact data. They want us to, you know, make a video. But, they also want us to pay them a market rate on their deposits.

And, they don't understand how we -- how we are going to be able to -- how we can't give them a market rate of return and make investments in communities that other banks don't want to invest in.

So, that's challenging as well.

MEMBER DEVAUX: So, and my name is Lloyd DeVaux. I'm President and CEO of Sunstate Bank in Miami.

And, the small community banks are competing on rate big time. CD rates are five plus. And, money markets are 3 to 4 percent.

The big banks seem to be buying the business. You know, put a certain amount of money here for a certain amount of time. And, do a certain amount of transactions or ACH and we'll give you $300 or $500 one time.

So, we're seeing a lot of that. And, maybe, that's just the way it always is. But, they have other sources of funding we don't have.

So, we're pretty much competing with high rates. And, we're trying to avoid some of the things that are not looked on the same way, like broker deposits and internet CDs.

And, we prefer to have a customer deposit that's -- that's where we try to go. And, we try to get the whole relationship. But, a lot of times we have people just shopping for the high rate.

MEMBER SHOEMAKER: Lillous Shoemaker, Magnolia State Bank in Mississippi. And, we are also a CDFI bank and have experienced intense deposit pressure.

What's interesting this go round, is that we have about 14 percent in public funds. And, the governmental entities, while they also want us to support low- to moderate-income areas, they have been the number one customers that want the very aggressive rates. Which has caused a challenge for us.

MEMBER BATES: Thomas Bates, Legends Bank in Clarksville, Tennessee. Deposit competition has been strong.

We have a lot of banks in our Nashville market, well, we have branches that it's very intense there. Clarksville has actually eased up a little bit.

We're still able to get CDs below the brokered rates, which we're thankful for. But, we do see a lot of competition.

We have several of the largest credit unions in the country in our market, because we have the military base. And, that creates, you know, some issues.

Public funds, we have quite a bit of public funds. But, they tend to be operating accounts that have Treasury management associated with them.

So, even though we're paying rates, we get to charge them, you know, normal fees. They like to see the -- they like to see the higher interest rate and they don't mind paying the fees.

So, that's -- that has worked out fairly well for us. But, overall, it still remains competitive. But, our margin has actually been fairly stable over the last 13, 14 months.

MEMBER HUANG: I'll try not to repeat what I said yesterday. But, I'm -- one thing that I’m finding very surprising is the amount of public funds that are at community banks.

Because, for the community banks in New York, we have very little public funds. I was having a discussion yesterday with somebody

from the FDIC, and they were pointing out that New York City alone has several billion dollars, tens of billions really, in public funds.

And, the amount of money that's going to MDI institutions, less than $50 million total. We have 150 New York chartered banks, I think.

All of those, New York State, New York City funds, are pretty much going to the top five banks in the state. So, we see very little of that.

In terms of competition, we're competing with Treasury. Two-year Treasury now is over 5 percent.

We're dealing with online banks that are also giving DD accounts at over 4.5 percent. Fintechs, nonbanks, it use to be we'd compete with credit unions and other banks. Community banks now, the market has expanded tremendously, especially after COVID.

For our security portfolio, it's still pretty conservative. We've always staggered

purchases. So, you know, as some roll off, the compression gets better.

And, for contingency funding, we continue to test, you know, the discount window, the Federal Home Loan Bank. We use it toBank Term Funding Program.

So, we continue testing and continue using it.

MEMBER HORTON: I'll add to that. You know, we were in the 99th percentile for the lowest cost of funds in our peer group, in the UBPR.

Of course, like everyone, we've experienced the same pressures on deposit costs, including the Treasuries, I think, has been one of the main competitions and credit unions and some brokered funds.

So, we've lost year over year only about 2 to 3 percent of our total deposit base. But, we've seen a shift, of course, from noninterest bearing to interest bearing.

We did have about 50 percent of noninterest bearing, which drove our low cost of funds. We're down to 45 percent, so not that bad. But, seeing a big increase in that.

We're fortunate that our net interest margin has actually expanded a little bit, because we're in ag lending. And, we have about 25 to 30 percent of production lines of credit tied to prime.

We have not had to go subprime to retain that business. So, that's helped our margins.

In terms of our securities portfolio, we have about 40 percent in held to maturity. We did have it all in available for sale.

And, knowing that we could still pledge those securities with the fed term program and/or the FHLB, we decided that we were going to move about 50 percent, which ended up being our mortgage-backed securities and CMOs into held to maturity, which helped, you know, minimize the

volatility to capital ratios.

So, that was a positive move. So, but we are experiencing a lot of competition still on deposits.

So, thank you.

MEMBER MAUST: Trey Maust, Lewis & Clark Bank. I'd echo all the comments that have been made so far.

One thing I'd like to add that we've seen from a market pressure perspective is, the perception of safety of funds.

So, from the standpoint of non-profits, government entities, various others that maybe are not willing to take a chance in their minds of ever being criticized. And so, it's much easier to place funds at a larger institution, typically a G-SIB.

And, we've seen that happen more than once with some local non-profits and others, which was disheartening, especially when there's a rollover of the Board.

And so, that relationship is new or they're evaluating whether or not something above say the $250,000 coverage amount, even if there are alternatives like reciprocal funding that would cover everything.

It's just, it's too much to digest. And so, it's easier just to go to larger institutions.

So, I would further support the White Paper that was published last year. I really appreciated the various alternatives and thought processes behind it.

And, I'd hate to see that just sort of fade into the -- into the background and not, you know, be picked up and have as a point of conversation.

Because, every time there is either a crisis in the market or we start to have pressures like this occurring, it certainly impacts each of us.

And, I know there's not agreement

across, you know, the entire industry on whether or not full reforms should be enacted by Congress.

But, I'd love to make sure that that stays in the conversation, because I think, it applies just as much as price and pressure does.

MEMBER MJARTAN: I'd like to add one, just echoing everyone’s comments. So, Dominik Mjartan with OPTUS Bank in South Carolina. We're also an MDI and CDFI bank.

I'll add a little positive experience we've had is, I think, the sleepy money is awake now. So, customers are shopping.

So, we've had some opportunity to pick up some non-profit accounts and other accounts that are rate sensitive. We're having to pay up a little bit, but two or three years ago, we couldn't have gotten those accounts because the rates were so low, they had no incentive for them to move.

Countering that trend is very similar

-- we're facing the too big to fail disadvantage. So, we're having to pay interplay rates.

We're having to insure the money. And, we're having these conversations frequently with customers that, you know, consider moving from one of the G-SIBs.

And, they want to see insurance and ask is your money insured like the other institutions. And, I say no, but, with you we we need to insure it.

So, that's another cost disadvantage that we have. Another small, I guess, small positive that we've seen, a lot of negative trends out there in the community banking in the liquidity and deposits right now.

We've been able to -- despite that, we've been able to grow pretty substantially. But, on the bond portfolio side, we've been able to really pick up some good bonds and try to prepare for the potential downside in interest rates.

So, we're trying to prepare for what may happen. And so, that's been probably one single benefit and we are — – we’re very well positioned in AOCIs, you know, just less than 1, or less than 2 percent right now, I think.

So, that's, I see some positives in that.

MEMBER BARKHEIMER: Marlene Barkheimer from Farmers State Bank, West Salem, Ohio. On the deposit competition, pretty much what everybody else is seeing.

We're in a fairly rural market. But, public funds are important to us. The State of Ohio has a competitive bid process for public funds, which makes it very expensive to try to get.

Because of that, the larger banks are all bidding for those same funds. It used to be the local associations would bank with us, which don't anymore because of that bidding process that they've allowed.

The State has tried to put a home ownership program in place, which we're hoping is going to help to get some State funding. So, we've just become part of that. And, trying to get some funding that way.

We have taken advantage of the term loan funding program, Federal Home Loan Bank funding. We did see a run out of deposits because of the rates being very low cost of funds.

We tried to keep that low cost of funds as long as we could, until the competition basically started taking too many deposits out of the bank. And, we had to start paying up.

So, we were kind of late into losing margin. We were able to gain margin actually through most of 2023. First quarter 2024 is when we started feeling a little bit more compression to our margin.

So, we're hoping that's going to stabilize. I can't specifically say that's happened yet.

Securities portfolio, we do have a lot of underwater bonds that we're waiting to mature off. We've looked at selling early and have taken some opportunities. But, not a lot there.

But, we do have them staggered, so they'll be coming. And, we have tested a lot of our contingency funding and actually, it's helped to not have to meet the pricing that we're seeing on the deposit side.

MEMBER RICHARDS: Troy Richards, Guaranty Bank in Delhi, Louisiana. And, I'll echo the same comments to you.

It's a zero-sum gain in our market for deposit accounts. If we gain one, that means the bank down the street lost one. And so, there's good competition for rates there.

The only other comment I'll make is on the contingency funding source. We're an FHLB borrower. And, we like that program.

But, the pressure that we feel like we were going to be under to sign up for the discount

window, we went through the process. And, it was not easy.

It took us about four months to get set up with the Fed discount window. Four months. And, part of that is because we don't have sec -- I have four securities in my securities portfolio.

So, I don't really have one. So, I didn't -- I couldn't pledge securities to my discount window. I had to pledge loans.

Well, FHLB has a lien on all of our loan portfolios. So, we had to work through a subordination agreement.

But, the holdup was definitely not on FHLB's part. It was on the Fed's part. I don't really think they have enough staff to accommodate the demand that they had for everybody to sign up.

We finally got signed up. I got a very small line. I pledged three loans to it. And, I borrowed $5,000 for a day.

And, that was all fine. But, I've got to report now every month those three loans to the Fed, what the balances are, what the rates are.

It's just -- it's just a lot of trouble it seems like. I don't know that I'll ever use it, or I'll ever need to use is.

It is too easy to borrow from the Federal Home Loan Bank. I can take out an advance in five minutes, as opposed to the arduous process that the Fed has.

So, and that's our experience on that. I don't know if that echoes anybody else's experience.

MEMBER DRENTLAW: I -- I'll go --

MEMBER PLUMSTEAD: No, go ahead.

MEMBER DRENTLAW: Okay. Anita Drentlaw, New Market Bank, South Metro of the Twin Cities in Minnesota.

I'd echo the exact same experience. We did sign up for the Bank Term Funding Program.

And, pledged a lot of our underwater securities.

And, it was a very painful process, to be completely honest. We use the Federal Home Loan Bank as well. And, find that to be extremely easy.

The recent FHLB at 100 report is concerning, to be completely honest for us. Because we don't hold mortgages on our books.

And so, the idea that potentially they may have a percentage of your assets needing to be held in one-to-four family mortgages, could really have a large impact, I think, on the industry.

Because, we do use them for contingency funding, just because the ease is, I would say it takes less than five minutes to get an advance if you need one.

We do a lot of one-to-four family mortgages on the secondary market and sell through their MPF program. But, as it sits right now, I don't know that that will matter.

So, and contingency funding has been extremely important, because the deposits are in such high competition in our area too. Being in the south metro, we have larger community banks that are paying really high rates, as well as several credit unions that it just gets to the point you can't really compete. And then, we saw like, a huge amount through brokerage money being -- I mean, customers think they're like, FDIC insured.

But, they're really insured more by Treasuries. And, that was a huge outflow of our deposits.

More so, in 2023. It seems to have stabilized some now in 2024. But, that has had an effect, for sure on our cost of funds.

MEMBER PLUMSTEAD: Norm Plumstead, Honor Bank, based out of Honor, Michigan. I see a lot of heads nodding about the clunkiness of trying to borrow through the discount window.

And, that's certainly been our

experience as well. We recognize the need to diversify our funding sources and would like to utilize the Fed more. But yeah, the clunkiness of the pledging and the lack of transparency once you do borrow, you know, makes my CFO pull her hair out every time we suggest that to her.

One note in regards to contingency funding, or I guess, an additional note insofar as testing goes, and how it relates to borrowing, is that we do put an emphasis on a time-based approach.

So, minute one, day one, week one, month one. And so, that's why contingency funding and having a variety of sources is particularly important to us.

One final note in regards to deposit rates, we thought for a time in mid-March that we might be able to front run rate cuts a little bit. And, we thought maybe we could ease rates on our premium money markets back 10 or 15 basis points.

And then, -- and then, we pressed the pause button on that. And ended up having to borrow a little bit to fund loans.

So, we thought we were almost there. And, we thought that there was going to be a little bit of relief.

But, as it turned out, unfortunately, no.

MEMBER REIGELSBERGER: This is Kim Reigelsberger with Preferred Bank in Rothfield, Missouri, where agriculture is our main economy in our area.

You know, I've kind of, again, I feel like I'm saying the same thing everybody else is saying.

But, just what Troy was saying, the un -- we had the Bank Term Funding Program. We had our securities pledged to the Fed.

Well, all we wanted to do was move it to the discount window. Well, that was not easy either. I don't know why that would be so

cumbersome. But, it was.

I do think, maybe, it's a staffing issue. It seemed like we couldn't contact the same person a couple of times in a row if we had questions or just tried to move it.

I think, we have that accomplished now. We haven't tested it yet. So, that's our next thing.

So, I was a little bit frustrated at, I wish it was -- I wish they would take what they had initiated with the Bank Term Funding Program, the ease in which -- well, I say ease.

Once it's set up, it's easy. It wasn't easy getting it set up, and bring that over. Because, I don't find the discount window being any easier to deal with at this point. So, it's just a process. So, anyway, that's part of what that is.

But, we have been a little bit fortunate. We were flush with deposits before. We had all the liquidity in around 2021. Which,

we got another 20 percent increase in deposits.

Really made us flush in deposits. So, as we have seen our competition raise the rates because our local community banks are -- their loan-to-deposit ratio was high.

So, they need our deposits. Their rates, they were at 5, 5.5 percent right out of the bat. And, we choose to go slower.

We had quite a bit of cushion there to see some runoff. And actually, if we could get back to where we were at prior to COVID, we were going to be comfortable with that.

So, we're still watching that. So, that's been kind of interesting as we go. Our loan demand hasn't really slowed down any.

But, we were so flush with deposits that it's not – we're watching, but has not really affected us that much.

So, we've felt like that might be a positive for us. And, as far as our bond portfolio, we are not doing anything. We're just

letting the maturities roll off.

It's, you know, we're just like everybody else, they're all under. So, we're keeping track of that.

But, we do have the other line set up to where if we do need some additional funding that -- on our contingency plan, that's kind of what we'll do.

And, when I get back, we'll work some more on seeing if we got a discount window line set up, so.

MEMBER SHOEMAKER: Real quick. Our primary source of borrowing, of course, is the Fed and FHLB. We were set up with the Bank Term Funding Program.

But, it was easy for us. And, seamless to use the discount window. We ended '23 with approximately 20 percent liquidity.

Fifty-one percent of our security portfolio rolls off in the next three years. Sixty-eight percent rolls off in the next five

years.

So, we're very short. But, it was a positive experience. We tested it. Only, we did not need to use the discount window.

But, we had a positive experience.

MS. SCHMIDT: Would anyone else want to talk about the market challenges, market risk challenges, or add to anything that they said before? I think we heard a lot about competition. You hit all of the things we asked you to, the securities portfolio and the contingency funding.

MEMBER HORTON: I'd add one thing if I could.

MS. SCHMIDT: Yes.

MEMBER HORTON: Trey and his comment, I'd really like an update on what we can do to help further this FDIC insurance reform issue. I think that's a very big disadvantage for community banks. The too big to fail, the money really when it did flow out, a lot of it went there. So I'd love to know where we're at on

that.

I remember the three proposals and the staff's recommendation. I think we really need that FDIC insurance reform. It will help community banks retain deposits. Thank you. And I'm Sue Horton from Wheatland Bank in Spokane. I didn't introduce myself last time. Thank you.

MEMBER DEVAUX: I would like to just ask a question here. We're an MDI also. A lot of the big banks have talked about deposit programs to MDI banks. Nobody is pulling the trigger.

And I met with one yesterday, the day before yesterday, and I asked him if it had to do with Silicon Valley Bank. Everybody was afraid of what happened and whether they're worried about liquidity. And everybody said, no, but they were supposed to have programs where community banks could get deposits from them at a below market rate to be able to lend to some of the communities that need it at a rate that was

more favorable to low- to moderate-income areas.

And I don't know if anybody has had any experience with that. But really we've seen nothing now. A lot of talk for a year and a half, two years, but nothing.

MEMBER JAMES: Yeah, Lloyd, Dom knows I spend more time thinking about this issue than I wish I did. But I think it's that rate pressure, right? I mean, I think a lot of what's happening is that the folks in the larger institutions that are paying attention to the MDIs are facing pressure to get a market rate of return on the money.

And it's a little bit dissonant because we know that if one of those G-SIBs puts aside $250 million and they invest it at a few - a couple hundred basis points. It could be 300 basis points below market. That's a rounding error on their balance sheet.

They wouldn't miss it. But yet they're asking for a market rate of return or

close to it. And I think that's part of the pressure that they're dealing with internally.

And I also think that they are -- this is just my opinion because I'm not inside those institutions. But I think that they are having a having a hard time running these programs through their internal processes, risk management processes about making deposits. I think it's kind of conceptually difficult for them to make deposits into smaller banks in a way that you wouldn't think it would be as challenging.

But I think they're having trouble getting through their legal departments, their other risk management departments. And so that's just my opinion. But if you have anything to add.

MEMBER HUANG: Sorry. If I could just -- going back to this contingency funding, FHLB, the Fed. We've been part of the discount window for a while now. Haven't really had to make too much use of it in the past.

So we're okay with it. But recently we've been getting a lot of regulatory pressure about FHLB in terms of lender of last resort and them not being so, contingency funding plan, et cetera. Our view has always been FHLB is not the lender of last resort.

But it is on our contingency funding plan. And after March of last year, we feel like, fairly or unfairly, we've been getting some pressure from various agencies all over saying that FHLB almost shouldn't be on the contingency funding plan. And we've always maintained the Fed is the Fed and that's what we use for it.

And how we pledge securities or loans is a business decision on what is posited. And we've always been able to move one to the other fairly easily. But we just wanted to make sure that the agencies understood where their bank's position is.

And sometimes we want to use the Fed more. But it has been cumbersome. And so

hopefully if it's a staffing issue, they can improve it a little bit and then we'll be able to make more use of it. Thank you.

CHAIRMAN GRUENBERG: Perhaps I can offer a comment on the deposit insurance matter that was raised. I think in the aftermath of the failures last year, there was a lot of interest in the Congress, I think it's fair to say, in looking at the deposit insurance system and considering changes to coverage. I think as things have sort of settled down in the months since those failures last year, that intensity of the interest I think is diminished.

And so you can talk to others. But I don't think there's a short-term outlook for anything to happen legislatively. And any change in deposit insurance coverage would require action by the Congress.

I do think of the -- we did that report last year, which I think was useful sort of laying out the history of deposit insurance in the

United States and options for making adjustments. The things that we suggested I think would might have the most viability and perhaps interest is increased coverage for business payment accounts. I think there is a recognition on our part that the operational nature of those accounts really effectively limit those accounts to one institution because you need to rely on that institution for your payment processes so you don't have the moral hazard of spreading it around.

But if - if a payroll accounts are not met it can have a destabilizing effect on a local community and for a larger institution even more broadly. So the moral hazard risk is not great. The financial stability benefit of higher coverage I think you can make the case for.

So I would hold some potential for that. And then the question, really two issues if you're going to consider that one definitional, it's tricky to define what would

qualify or not. And you don't want to have to create opportunities to game the system if you set something like that up.

And then also, of course, the level of coverage that you might raise it to, understanding that the higher the coverage, the greater the impact on deposit insurance assessments. So those are all things you'd have to balance, I think, in considering that. There also may be interest, by the way, in giving greater flexibility for the FDIC to, on a limited time basis, offer a kind of TAG account, coverages we did during the -- in the aftermath of the financial crisis in 2008.

We had that emergency authority that we were able to exercise, the FDIC in conjunction with the Fed and the Treasury. And the legislation that came after the crisis, we have that authority, but it requires a concurrent resolution for Congress to approve it, which in a stress environment may be difficult to do on a

timely basis. So to consider legislation on a time limited basis would allow us to do that without a concurrent resolution, I think is also something that may get some attention.

And in a severe stress environment, might be a useful contingency authority for us to have. So in thinking about changes to deposit insurance, those are probably the two things. Not in the short run, but I think may get some attention and may have some interest.

MEMBER HORTON: You know recently with the bank failure that just occurred earlier this week, of course, all the articles are coming out in the Wall Street Journal and others will expect more bank failures. And I think that's why I brought it up is I hope we're not going to start this up again with this fear of customers that perhaps they need to move more funds to the larger institutions that are considered too big to fail, because I agree, things had calmed down. But the fear is, is it going to start up again?

CHAIRMAN GRUENBERG: I hear the concern. I think that resolution went pretty smoothly by the way. I would add for what it's worth just as an informational point that looking at liquidity last year.

At the end of the first -- and this issue of money leaving the smaller institutions or the regional banks for the largest institutions and the G-SIBs. We saw a little bit of that at the end of the first quarter. Not in the second quarter at all. And near as we can tell in terms of deposit loss by the banking industry, to the extent that occurred, the money generally went to the nonbanks, the nonbank money market funds that were offering higher rates.

And that's -- to the extent there was liquidity loss, that seemed to be the principal place it was going. I will say just by informationally for the -- our most recent numbers are from the fourth quarter of last year. And overall, liquidity for the system, domestic

deposits grew.

And that was across asset sizes for the industry. And both insured deposits and uninsured deposits increased in the fourth quarter. For uninsured deposits, you have to take into account the internal consolidation for one of the biggest banks.

But if you do that even uninsured deposits for the industry increased. So going to the point -- liquidity, since the failures of last year, does seem to have stabilized for the industry. It's one of the positives from the fourth quarter results.

We're going to get the first quarter results at the end of this month. So we'll see where things are. These things do move. But anyway, those are the latest numbers we have.

MS. SCHMIDT: Anyone else? Thank you very much for your market risk robust feedback. I appreciate that. I think Nikita will move us along.

MS. PEARSON: Thank you all very much. It is time for our break. We will begin our session again at 10:15. See you in 15 minutes.

(Whereupon, the above-entitled matter went off the record at 9:59 a.m. and resumed at 10:15 a.m.)

MS. PEARSON: Welcome back. We have our panelists here with us and we will pick back up on our discussion on banking conditions. I'll turn it back over to you.

MS. KALSER: Well, thank you, Nikita. Welcome back. I really enjoyed this morning's discussion. So now we're going to turn our discussion to credit risks.

While asset quality metrics remain favorable for the overall industry last year, weakness became evident across commercial real estate and consumer lending portfolios. And I know that many of you have loan portfolios that go beyond these two portfolios. But for the interest of time, I'll address comments on these.

For the banking industry as a whole, CRE loans held by banks reached a record high of $3.1 trillion in 2023. And CRE loan growth slowed late in the year reflecting a number of factors, including weakening commercial real estate conditions, higher interest rates, as well as tightening of underwriting. Nearly all banks participate in CRE lending to some degree.

But there are distinct differences when looking at banks across asset size groups, which is what we show in this slide. And we've talked about different bank size groups earlier this morning. But for this presentation, we're looking at banks -- large banks over $100 billion. Small banks are under $10 billion. And the mid-sized banks are between $10 and $100 billion.

Now seen in this slide, we show the median percent of CRE loans to capital and loan loss reserves across the three bank size groups. The red line -- red dotted line -- let's see.

Thank you. The red line, the CRE concentration on banks with assets between $10 and $100 billion, which is the highest line is the highest among these three bank groups and has risen more sharply.

Also shown is that the upward rise in the CRE concentration for this mid-size bank group started at the end of the last downturn while the concentrations of the other two bank groups have been stable, were declining over this time. Now in contrast to the mid-size banks, the CRE concentration among smaller banks with less than $10 billion which are primarily community banks, the blue line, I think, has remained relatively constant over the past decade. CRE concentrations to capital is lowest among the largest banks defined as those banks with assets greater than $100 billion.

And while large banks play a prominent role in CRE lending, these loans represent a smaller share of their total capital base. Now

let's turn to the next slide. So this slide shows the same bank asset size groups by CRE loan delinquency rates and it's for non-farm, non-residential CRE loans.

Here, the increasing trend in CRE loan delinquencies is most pronounced among the largest banks. A good portion of this reflects weakness among non-owner occupied properties which includes many office loans. Notice that the upward trajectory of CRE delinquencies among the large banks began in 2020, which reflects in part the effects of the pandemic, specifically the increased use of remote work and many of this in office properties.

While rising sharply last year and considerably above the pre-pandemic level, the large bank's CRE delinquency rate, the median remained well below the group's peak from the last cycle. Community banks reported the lowest delinquency among the three bank groups. This delinquency rate was below its pre-pandemic level

and well below the group's prior peak.

Mid-size banks, the group that experienced the sharpest rise in CRE loans this year of their capital, showed a slight weakening in its delinquency rate in 2023. While rising slightly from the prior year's level, the delinquency rate was near its pre-pandemic level and also below its prior peak. In fact, the median CRE delinquency rate for all three of these bank groups was below their respective peaks from the last cycle as of year-end '23.

Now it's been chronicled in the press, there continues to be considerable amount of uncertainty regarding the outline for commercial real estate while various reports indicate more workers are returning to the office now than a year ago and weekly occupancy levels have improved. Occupancy still remains in offices below the pre-pandemic norms. Demand for office space remains weak, particularly in some larger markets, including San Francisco and in some

parts of New York.

And in turn, valuations of office properties have declined more than other CRE property types since the end of 2019, the pandemic, particularly those properties in central business districts. Other commercial real estate property types also have experienced some weakening, probably less so than many of the office properties in large markets. But there's still a potential for further weakness.

In addition to the type of CRE property, its location, the condition, the age, the amenities, and LTV are all factors that affect the cash flow, the valuation, and ultimately the repayment capacity of the loan. Given the uncertain outlook, refinancing of CRE loans in this environment is very challenging. And in many cases, current market interest rates are much higher than the interest rate on the existing loan.

While the banking system has loans

maturing at all different periods, there is a sizable amount of CRE loans including bank CRE loans that are scheduled to mature this year, in the next few years. While some reports suggest that some CRE loans that were scheduled to mature this year in the tough market, some of them may have been extended. Nevertheless, CRE conditions and credit risks continue to warrant close monitoring.

So let's move to consumer loans. This chart shows the median pass-through rate for total consumer loans by each consumer loan type just for community banks. The delinquency rates across consumer loan types all dipped, meaning they improved early in the pandemic in 2020 in part reflecting the various programs, federal programs, and other programs designed to support people that were affected by the pandemic.

Last year in 2023, the delinquency rates on consumer loans held by community banks started to trend upward. Although the

delinquency rates across all the loan segments here at the end of the year still remained lower than their levels pre-pandemic. While delinquency rates for consumer loans held by the community banks remained comparatively low in 2023, reports suggest that there's increasing financial stress among borrowers with lower incomes and/or lower credit scores, which could portend further weakness. Some of these borrowers may not be homeowners and thus may not have benefitted from the rise in home prices over the last couple years, nor they may not have the same type of savings that were invested in some of the high deposit rates that we've heard about earlier this morning. Next slide.

So with that, those brief comments on credit quality, we look forward to hearing your thoughts on what's happening in your banks and your communities that you serve. We've included some questions here. But of course, please include any loan segments that you see - you feel

are important to your community. So with that, I will turn it over to our members. Thank you. Anyone -- so go ahead.

MEMBER SHOEMAKER: We just shored up our CECL for the first quarter earlier this week. And it was in line with what we had anticipated budget-wise for our loss concentrations. So no material changes whatsoever.

The bank is doing very well. But I'm a little concerned with the disconnect. Our loan growth is good, deposit growth is good. But just on the street from friends, I'm talking about the ag industry and the construction industry and consumer-to-consumer car sales, for example.

That seems to be struggling whereas the bank is doing fine. So I don't really understand the disconnect between what the consumers are feeling and what the bank is experiencing. And I think commercial real estate in the south, particularly in Mississippi, very strong, no delinquencies.

We're seeing the most delinquencies in a very particular category of commercial lending. And that is with the construction industry such as a piece of equipment, a dozer, for example. CRE, very minimal delinquencies thus far.

MS. KALSER: That's good news. That's good to hear. Thank you.

MEMBER DEVAUX: So again, Miami market, the numbers I've heard, it's 1,000 people a day moving to Florida. So we haven't even seen the office crisis. But I will tell you that even though the delinquencies -- the vacancies are still under 10 percent, they are up a little bit.

I think a lot of that might be still work from home. And south Florida, the traffic is horrendous. So it's hard to get people to drive.

But I think the smaller banks have trouble with the big office because it's just above their lending limit. So you don't see a lot of the small banks doing a lot of office

space. The retail space is doing great.

You have the neighborhood retail. You need the grocery store and the nail salon and the hair salon and all the things that are in those little strip malls are all doing very, very well. And so we haven't seen the stress yet.

We don't do a lot of consumer lending. We don't do mobile assets generally, boats, airplanes, cars. We don't do a lot of that. But so far, it's been good. The volume has been good and the market is still very strong and still a lot of people coming in.

MEMBER BATES: The Tennessee market, particularly the middle Tennessee market remains relatively strong. We have about half of construction loans in Nashville SMSA and half in the Clarksville and Hopkinsville MSA. Strong inflow of people.

We do quite a bit of construction lending. We've always been a CRE bank ever since you had to start reporting that. We're actually

at our lowest, which is a surprise to me.

We're at our lowest level we've been in several years. But no issues there. We have no delinquencies in that category right now. And with the number of jobs that we have coming to our area and the number of folks, it's holding up much better than I anticipated it to during this elevated rate cycle.

It's sort of been counterintuitive to me. Our mortgage production has been stronger the first quarter of this year than any quarter last year. So that's been a big surprise to us.

As far as lending conditions, we are seeing the larger institutions, particularly the larger regionals strongly pull back from construction lending. So that has created a little bit of stress because we have so many people coming to us. So we're having to pass on things that we might have done a few years ago but we just can't handle the volume that's coming right now because it has been a significant

decline amongst the regionals in that area.

MS. KALSER: That's interesting. Thank you. Oh, excuse me.

MEMBER REIGELSBERGER: I might add. And like I said, I'm from north central Missouri. The ag economy has been doing really well the last few years.

Two years ago, that they had corn, soybeans. That's our primary crop to sell. They got commodity highs, highs ever. I don't think we're going to see that in 2024.

They're saying -- I mean, we're already seeing the shrink back in the commodity prices. Seems like I don't think for our bank at this point – I mean, we'll monitor it. But most of our farmers are seasoned farmers.

And like I was mentioning earlier, probably the average farmer is in their 50s. So they've been through this cyclical times in which pricing has gone up and gone down. So they adjust accordingly.

I don't think we'll see too much with that. As far as agricultural land prices, if you're just buying the ground to put it into farming, those are holding steady pretty well. But what we're seeing, it's the recreational hunting, whether it be duck, some kind of waterfowl, whether it be deer.

They're driving the prices up significantly. If there's any timber on the ground and it's ground that's up for sale, it's going to go beyond the price that a local farmer can afford. So that's been interesting to watch that.

We're close to a federal reserve, which, you know, that brings in a lot of waterfowl. So those conditions are something we're keeping track of. We're going to do some rate shocks on interest rate as we do the new operating loans for this year.

But we've had that conversations with our customers. We think right now they're

projecting at 18 percent compression in commodity prices. So we'll see now on the flip side if you're in the cattle market, you're probably seeing some much better prices.

The problem is, is talking about climate change is in north central Missouri, we've kind of been having a drought the last three years. Now the last two weeks, we've had several rains.

But it takes more than three or four inches in a week to recover from drought conditions, which is why cattle prices are higher is because last summer you had to sell some of your herd because you didn't have the hay. You didn't have enough hay to put out. You can't feed your animals. You’ve got to sell your animals.

We're seeing a little reflection of that this spring. Those prices are up. So we'll see where that leads. Ground is dry. Three feet down, it's like concrete.

We need some more moisture to be able to raise more hay, to feed and graze more hay, to raise the prices, and besides that, just get ponds full again. So that's something that we're always aware of and trying to keep into consideration. The only thing I might add on the cyber risk, that is one of the questions on here, we've taken a -- we have actually met with our insurance underwriters.

We've discussed cyber risk with them. What are we not thinking about? What can we do different? How much will our premium change if we up different coverages?

So we've been very proactive I feel like in that aspect. I'm not sure this really falls under cyber. But I don't know what to do with our deposit accounts who don’t, who fall into the scams.

It's amazing how many dollars, if you just look at our little bank, we're only $145 million. The first four or five months, and we're

going to be bumping $20,000 in losses. And they're not always the same scam.

That's what's interesting. How do you put parameters up to try to help your customers and try to educate? But that doesn't seem to work to control those losses more.

I don't know. Again, they're not the same scams. Every one of those that we've dealt with, there's a different twist to it, whether it's got to do with -- some of these cash apps concern the heck out of me. They really concern me.

Our customers are too trusting, and you can't change their minds hardly when they get in these romance scams. So I don't know what else to do about that. It is somewhat cyber in effect. This is being generated from social media probably. But anyway, I don't have an answer to that question.

CHAIRMAN GRUENBERG: Interesting.

MEMBER PLUMSTEAD: So Honor Bank is

located in northwest lower Michigan. And we've seen a large influx into our area, not South Florida influx. But that's meant a lot of opportunity on the construction and development side.

And we're primarily a CRE lender. So we do a lot of commercial lending. We've seen sales slow a little bit year over year as well as leases have slowed a little bit.

We on our end have tightened up a smidge when it comes to speculative financing. We don't want to find ourselves over our skis as in 2008, 2009. And insofar as weakness in the portfolio, we haven't seen that.

We haven't seen any deterioration in our commercial lending portfolio. We don't do much consumer lending anymore. In fact, last year, we made the decision to get out of the consumer lending business altogether because we found it frankly too challenging to compete against the credit unions and dealers. So we

made a decision to stop that business line.

MEMBER DRENTLAW: I would say -- so South Metro, Twin Cities, Minnesota -- we have not seen a deterioration either in our loan portfolio. We have a significant amount in commercial real estate. Most of that, though, is owner-occupied.

So really -- I mean, you're really lending to the business. This just happens to be the building that they're located in. Again, I think somebody else said it.

Like, we're so small that, like, large office buildings and stuff just don't really affect us. So we literally have zero past dues on our last Call Report, no non-accruals. And we haven't really seen the need during our annual reviews to really downgrade any loans to substandard or anything either.

We do keep making provisions on a monthly basis only because we've started to see some loan growth again. 2023 was very slow. I

think everybody was saying, well, I'm just going to hold out because they're going to lower rates the first quarter of 2024.

And now it seems like people are just sick of waiting. And they're, like, well, we'll refinance when rates drop. So our pipeline has increased a lot in the last couple months.

And I agree with Tommy. It's been funny. This last quarter has been better for mortgage loans. And I think the same thing. People are just, like, well, bite the bullet. We'll refinance once the rates go down.

One thing to note when I just heard this last week was somebody -- a bit larger bank in our market basically told their lenders to not even bring up a potential loan to loan committee unless they had the deposit relationship to convert as well. And that was new last week in our market. So I do think we're putting a lot more emphasis with our lenders on bringing over deposit relationships and even part of their

incentive program. More focus is on having that full relationship but to not even bring a potential loan was another level that we had not heard or seen before in our market.

MEMBER HORTON: Hi, just a couple comments. On the commercial real estate conditions, our asset quality has remained excellent. We actually had zero loan losses net over the last decade.

But we're watching multifamily very carefully. We're seeing -- I mean, there's still a huge demand by developers that want to do multifamily projects left and right. I mean, just a lot of them, large, like, $20 million type projects.

And what we're seeing is a lot of rent concessions already, move-in rent concessions, slower stabilization. So we're watching that very carefully and we feel that we're at our concentration limit. And we really aren't wanting to do more multifamily projects at this

time.

So that's something that we're watching carefully. And also the ones that we did do and again we're kind of full now, we have a pipeline and we've said that's it. They definitely had to have large deposit relationships and really good secondary sources of liquidity.

On the ag side, we in Washington state, we're one of the top ag production states in the whole country. We have the top number 1, 2, and 3 crop production in over 25 different crops, everything from apples, cherries, wheat, garbanzos, potatoes. It goes on.

And that's really because of the water. We have the strong Columbia Basin irrigation project in the Columbia River. So we do benefit from that even in the drought. We have adequate water.

So we're not seeing really any weakening in the ag area for that reason. So

just wanted to kind of throw those two points in, multifamily and ag. Thank you.

MS. KALSER: Thank you.

MEMBER RICHARDS: I know for Guaranty Bank in Delhi, Louisiana, our loan loss provision, we took advantage of the equity -- one time equity adjustment last year, just anticipation of what the economy was going to do. I'm glad we did that. Also, we are a CDFI bank, at least we are right now.

I don't know that we're going to continue to be because of the new certification requirements are pretty tough. But anyhow, the last two BEA awards that we received, we funded our loan loss provision with our CDFI award. So thank you, Uncle Sam, for that. As far as any deterioration in any of our loan portfolio, we have a very specific lending that we do that's commercial real estate, but it's 1-to-4 family residential properties.

We have a lot of borrowers who have

rental portfolios. And we do a lot of lending to finance the purchase of depressed properties. and we do the lending to accept the properties. So we're increasing the availability of affordable housing in our market areas.

But our landlord customers are having problems getting paid on the rents. Seems like when all the government money kind of got cut off, people had raised their standard of living because they had all this money coming in. When the spigot got cut off, they don't really want to go back to their standard of living.

So they'll pay everybody else, but they won't pay their landlord. Because of the way the law is written, it takes forever to get somebody out of a house. And they squat, and it's tough.

And so we've had to tighten our lending standards in that area to make sure there's adequate liquidity on the part of our borrowers to be able to absorb those rough times.

So we've seen some of that. Our past dues are probably as much now as they've ever been.

But we're managing it and we're working through it. We got good collateral. It's just the ability to repay is not always there. So that's what we're seeing.

And Kim, I have to echo some things you said on these scams. I know we hadn't gotten to those risks yet. But on the romance scams and things like that, one of the things that really disturbs us is some of the recent comments made by the OCC director where he was in a speech had said that he feels like banks should be splitting the losses that our customers experience when they actively engage in these scams.

And I would hope that gets killed immediately because you can just turn the lights off and call it a day if that ever goes into effect. It's one thing that we're responsible for fraud losses when our customers are innocent victims. But when they're active participants to

make us be responsible is just insanity on another level. But anyway, I wanted to comment on that.

MEMBER BARKHEIMER: Starting with the CRE concentration, we're a non-metro area. So I have nothing there to really respond to. As far as general lending conditions, have remained extremely low on delinquencies. So not seeing anything there.

What we're hearing is to watch for trucking as being a precursor to areas. So we have kind of started getting hold of our firms that are more involved in that to be watching to see what we’re seeing there to know if there’s any other weakness that we need to see on that going forward. But at this point still, we know of a couple of places that have cut back a little bit on drivers.

So they’re not as active as they were. Still doing fine as far as where they are. So not a major issue at this point. Overall, lending

conditions, our ag community has had their best couple of years. So we are thinking that’s not going to keep going forward with the commodity prices the way they are.

But I guess the one concern I have with the loan loss provision is we use the Fed scale model. And because of the CRE concentrations of others, I’m not exactly sure how that’s going to flow through with the numbering. We have seen a lot of excess in our reserve calculations kind of be getting eaten up a little bit. So I don't know if we're going to end up having to beef up reserves even though we're still at an extremely low loss level.

MEMBER DEVAUX: I just want to make a quick comment on insurance because it seems to be it should be a problem for anybody on the coast. But our borrowers are seeing sometimes doubling and tripling the cost of wind insurance. And it has led to decisions that they normally wouldn't make, like, not buying the property or selling

the property or coming to the bank and begging for mercy.

Obviously, flood is non-negotiable. But we've had customers who are buying a property that have dropped their loan amount down to 50 percent of the land value, which is what we would lend on and not even include the building in our collateral. It really had become a -- it's really a big problem in Florida. The hurricane that hit the West Coast really did a lot of damage as others in the past have done.

We were in Tallahassee meeting with the insurance office. They did tell us that the laws that were passed in Florida will have a lagging effect on this, will eventually make a difference. And in fact, Citizens who's our insurer of last resort has said that they lost 300 and something thousand policies in the last quarter last year which is a sign that some of the big carriers are starting to come back in the state and starting to see an improvement. But it

is a significant issue for borrowers right now.

MEMBER HUANG: Just really quick. I echo everybody else. We're mostly commercial real estate, commercial lending. So our portfolios remain strong, very little in past due, non-accrual, impaired loans.

So we just finished our CECL as well, and it was pretty much on budget. We had good loan growth last year. This year has been pretty decent for us going in. Our pipeline is strong.

But anecdotally, we don't do very much consumer loans. But we get a lot of requests. And we hear a lot from our customers that a lot of that government money, COVID, that's all gone now.

But the prices are still up there, right? The cost of eggs, the cost of milk, just cost of living, inflation has really hit people's pockets. And so while some of our business customers might be doing okay, the first ones that are going to get hurt are the landlords.

And so a lot of people either can't pay, won't pay. It's just a difficult time for a lot of consumers right now. And while that doesn't affect us directly, we do know that we are seeing our consumer accounts, DDAs, balances are getting a little bit lower. And we can see something has got to give and probably soon. So we're monitoring that right now.

MS. KALSER: Thank you.

MEMBER MJARTAN: I would like to echo a little bit of the disconnect comment that you mentioned. So our bank is a CDFI. MDI is almost 100 percent of loans.

Our majority minority communities are persistently poor communities or underserved communities otherwise. And despite that, we've been hovering at less than one percent and nonperforming for years now, even though we've grown exponentially almost every year. So I'm a little confused frankly why we haven't see more deterioration given the consumer sentiment is

pretty poor.

But the portfolio continues to perform exceptionally well. In fact, every one of our loans that's on a nonperforming status, maybe there's one that's not. But it's ten years old or older.

So none of them originated in the seven or eight years. So if you took out the legacy loans as we call them, we have zero nonperforming assets basically. But we're paid as bankers to be concerned.

So we're, of course, concerned about it. But we're also a little bit confused. The commercial real estate conditions, I think like most, we have a lot of owner occupied.

But we are carefully looking at every new deal about what kind of industry it's in. And we've seen really good success with those on our properties that require customers to come in. So there's almost no possibility that work from home would ever impact it negatively because

there's just kind of, the retail markets are performing extremely well.

And we don't have the thousand people a day moving to South Carolina. But there's several hundred people that are moving in every year. So we're definitely riding that wave of just influx of population.

Incomes are holding steady. One thing I will say is compared to some of the other states where we see going back a little bit to the deposits and it's related to the liquidity when we're doing commercial real estate. We've been looking at the average.

And I haven't found perfect data on it. So maybe the FDIC could help us with it. But the average deposit accounts in some of our markets, particularly South Carolina, when we go look at underwrite commercial real estate, are a fraction of that, for example, in Florida.

So looking at the Florida banks, I have a bank that I'm involved with in Florida,

the average deposit accounts there are ten times or more, even what the customers bring in when they ask for commercial real estate. So that's a little bit of a disadvantage we're facing in some of the smaller markets is just the liquidity. Customers are coming in with very strong assets, good cash flow, good history, good industry.

But their liquidity -- their on-hand liquidity is a tiny fraction. What I'm seeing, our peer banks in New York or in Florida or somewhere else. And that limits us in terms of generating liquidity with each commercial loan that we originate.

MS. SCHMIDT: I'm wondering if anyone can speak to what's occurring when you have CRE loans that mature and it's time to refinance or renew. We're perplexed too. Everyone says it's excellent.

But we're been talking about wall of maturities and interest rates are higher.

Insurance costs are higher. Taxes are higher. Their overhead is higher. What are you doing or what are you hearing your competitors are doing when these banks come up to refinance?

MEMBER SHOEMAKER: We have a robust CRE lending and our delinquencies have not been a problem. And I do want to add our consumer delinquencies are, like, half a percent. We're relatively low.

In our market, the competition is so fierce for CRE loans that the customer understands. And they have adjusted to the rates and they're expecting the rates. So there's still strong competition to get the business, and we have fared very well.

MEMBER DEVAUX: You know, a lot of our renewals are formula driven, which is a problem because it's spread over five-year, spread over three-year. And it's not unusual for a customer to get a 9 percent rate. We are negotiating with those customers to try to get a rate that's more

reasonable, closer to what we would lend out today than to make them pay a 9 percent rate.

It's just not feasible. So we're trying to be where we can with the customers with a good record. The collateral is good. The LTV is reasonable. The debt service coverage is good. We will negotiate the rate to get something that's a little more reasonable, even if we just do a three-year renewal instead of the five-year to give them a little better deal.

MEMBER CROCKETT: Carolyn Crockett with First Security Bank in Nevada in Las Vegas. We're being very proactive with our portfolio. We're looking at upcoming rate resets as well as maturities.

And I'm trying to get ahead of, like was mentioned, working with borrowers to do a rate modification to something that would be current market today versus the 9 or 10 percent that they would reset to. And some of them are calling us ahead of time. But the last thing we

want to do is wait until it's a troubled debt and have to deal with it.

But overall, we are too a business bank. We are heavily commercial real estate concentrated. We don't do any consumer lending.

We haven't seen any deterioration in our portfolio, no delinquencies, no problem loans to speak of. But I do believe that prolonged higher interest rates are going to have an effect on that as these rate resets come up and they mature when borrowers can't meet their debt coverage ratio requirements. Or they just don't qualify at maturity.

I haven't seen it yet. But I don't think we're out of the woods. I think that is something that can happen if these rates stay longer -- higher for longer.

And then as far as what's going on in our market, the Las Vegas economy is very stable and in fact strong. Our visitor counts are up. Hotel occupancy is up and even higher than pre-

pandemic levels.

Nevada -- gaming wins are reaching new levels every month. So the economy is good. We find lending is restricted not so much from an economic concern but more the liquidity factor.

We are looking at loans really carefully. Does it make sense? Do we have the liquidity if we have to borrow or buy brokered deposits to fund them? Does it make sense?

But you're putting them out at 8 and a half, 9 percent to make a good spread on that. But right now, our portfolio is good. But there is some concern that if rates stay high, we're going to have some problems. Thank you.

MEMBER DRENTLAW: I was basically going to kind of say the same thing. I think that's the beauty of a model of a community bank is that we're proactively looking and talking to our customers well ahead of when the maturity is coming due and being able to look at the full relationship. I mean, we do give credit for

deposit accounts.

If they have a healthy relationship with us, they can get a little bit better rate. And so I think working with them instead of just letting a loan mature and reset to whatever it was based off prime before is not really how we operate. We do a full review, and risk rate them again and look at the relationship. And so it really -- although customers don't love paying a higher rate, it's not a surprise to them either.

MS. KALSER: Go ahead.

MEMBER BATES: I think that we've seen very similar. We started probably about a year ago forecasting out a year to 18 months in advance and just pulling the maturities. And really what I was seeing in that earlier time when the rates first shot up is I wanted more to be maturing so I could start bumping them up.

But it's been fairly -- we don't have big blocks that are coming due, and the ones - I mean, it’s a shock for them, I mean obviously.

But we've had so much growth of population that are -- particularly in our multifamily. Our rents have gone up quite a bit since we recently had underwritten them and occupancies have held up pretty well. So we've not had any major issues in that area. And so that's been very fortunate.

MEMBER MAUST: One other comment to make. Those of us that are at one time are currently concentrated in commercial real estate, the 2006 guidance will not -- maybe at the time when it first was issued, something that a lot of banks looked forward to, instill discipline in a variety of areas, including stress testing at origination. So what we end up with is debt service coverage ratios that are probably much higher than what you'd find at, say, a mid-sized bank or larger.

The ongoing stress testing, the concentration management process. And we ended up with -- our average debt service coverage ratio on non-owner occupied is over 170, so 1.7.

And owner occupied is over 2. And part of that is just as loans mature. But a lot of it has to do with the initial origination process.

Now there's competitive pressure, say, in the market that might result in those occasional loans that do get adjusted maybe down a little bit. But it's pretty uncommon right now. I think it was mentioned before, it's an expectation. Borrowers know that it's coming and they've got the, either adequate liquidity or cash flow to support it.

MEMBER RICHARDS: One of the concerns that -- loan pricing has been mentioned. One of the concerns that we have is that if 1071 comes into play, that's going to seriously impact our ability to competitively price these commercial loans which are all individualistic as far as their own qualities. That's just going to be taken away, and it's going to really have a drastic negative impact on our ability to properly price these commercial loans.

MEMBER SHOEMAKER: And I need to make a comment since I'm a Mississippi coastal community. The number one economic development issue that the coast is facing is insurance. Troy and Lloyd can echo this. It concerns me with insurance premiums for consumers.

It's not been an issue yet. But it is forcing some consumers into foreclosure, particularly those consumers that have higher-priced mortgage and the insurance is escrowed which is meant to benefit them. But we're seeing them pushed in the southern part of the state, outside of our market where they can no longer afford insurance premiums.

And I know Troy and I discussed this at the last meeting that it's a huge issue whether you're a church or a business getting adequate insurance coverage. The Mississippi legislature recently had a bill as they had in the past to fortify roofs to help improve insurance rating. And that did not pass.

So there's other non-profits that have come in. And for example, a $15,000 grant toward repairing an old roof and approximately 7,500 for new roof installation. But the insurance issue is really impeding economic development in Mississippi.

MEMBER RICHARDS: I'll echo. Louisiana has a crazy law. It's a three-year law. No other state in the union has it. But if you're with your insurance company for three years, they can't drop you.

And so it has been a real problem getting new insurance companies to come into the state because of that stupid law that we have. So efforts are being put forth now to try to undo some of that. But we're seeing that being a real -- insurance is a really big issue.

MS. KALSER: And I think it's -- I'm sorry. And I think we're seeing that insurance in other states. In fact, Krishna was going to cover that quickly.

I just want to thank everyone for the credit quality session. For me, I think it validates what we're seeing in the data that community banks are against the trend where credit quality has been very stable and your concentrations have been very stable. And you're in owner occupied which have performed better. So thank you for that. So if we have a minute or two for Krishna to do the last --

MS. PATEL: How much more time do we have?

MS. PEARSON: It's 11:00, but you can have a few more minutes.

MS. PATEL: I think we've covered some of the topics of the next discussion issues. If you move to the next slide. Of these other risks, we started talking about insurance and climate-related risks. We talked about drought. We've also talked about some cybersecurity issues and with the fraud schemes. Does anyone have any comments about those topics or any other thoughts

on those issues?

MEMBER DRENTLAW: I would say part of the economic conditions in our area is a huge housing supply issue. There is just not enough housing. So people are spending what used to maybe be a $250,000 house is now a $400,000 house.

And that has really created issues on the market. I mean, I have a friend who is a realtor. And I think, it was like, a $280,000 house in the southern part of Minneapolis. And there were over ten offers.

There were ones that waived inspection, and it was a house that was 80 years old. So she did not want her client to do that. But I think that is -- that's becoming a real issue in a lot of the metro type areas is having that housing shortage. So we've seen that for the last several years unfortunately.

MS. SCHMIDT: I think that's nationwide.

MEMBER DRENTLAW: Yeah, affordable.

First time homebuyers having a $400- or $500,000 home blows my mind. So --

MS. SCHMIDT: At current mortgage rates.

MEMBER DEVAUX: And that's the same -- Florida is the same. With the 1,000 people a day coming in, affordable housing is a problem and traffic is a problem. You can hardly find a place affordable in the Miami area. And if you move out of the Miami area, you're going to spend a long time trying to get to work.

The other -- I had one other comment related to -- not cyber. But, oh, Florida recently passed a bill to allow credit unions to take public funds. And I know this is -- some states have it and some states don't.

We haven't seen the impact of that yet. But they don't pay taxes. So we know that they're going to be able to take a significant amount of public funds.

I don't know how that'll impact

liquidity in lending. But that is just starting because it just passed. So we'll see what happens.

MEMBER HORTON: Speaking of other risks, one thing that we're very concerned about in the state of Washington, we've had three credit union acquisitions of banks. And, as I understand it, right now the one that's in process is one of the largest that's ever occurred by Alaska Federal Credit Union acquiring a bank in the Seattle area. So we worry a lot about this and the impact even on the federal tax rules, the state tax rules.

Certain states I know have prohibited it, including Idaho, and I think some others I heard about here from other participants. So I would love to see some federal action in that area because I think if you look at long term, the destructive impact, again, both federally and at the state level and at the community banks, it's very, very significant. In terms of

affordable housing, our bank has worked with some of these housing trusts in some of these areas that are, like, resort communities where people just can't afford to live in those areas.

There's not entry-level housing. Some of these housing trusts, they collect large contributions from wealthy people in their communities. And then we come in and you have to provide -- you get great CRA credit for it. But you do have to provide generally like a 30-year fixed rate loan product in your portfolio.

We've tried to look at secondary market opportunities for these loans. And they really don't exist in a way that works with these housing trusts. So that's something you can look at in your local communities. And I think it's very needed and it can be helpful in other ways, like CRA.

MS. KALSER: Thank you.

MEMBER MJARTAN: One other risk, I wanted to go back to the cyber. But it's also

identify theft, which is related to that. We've seen a massive rise in attempts at account takeovers, everything from elder abuse to -- we have a lot of aging customers.

But the rise of the technologies that enable those account takeovers is stunning. We're starting to see everything from just beautifully executed attempts at account takeover. We suspected one of them had some ChatGPT or some kind of technology.

We even did conference calls with the customers to validate them. And they still managed to try to get around. I think for us as a small institution, we're starting to see a lot of expense.

We have three full-time BSA/AML team members in addition to IT, three in IT now. And they're spending disproportionate amount of time now really on fraud and prevention, cybersecurity instead of what they were doing two or three years ago. So I think that's a huge risk for community

banks.

And you may have seen the articles about Citibank and where their liability lies. I think that's another concern we have for us long term. The regulators may need to provide some clarity and guidance.

Where's the liability in these various attempts? Because those lines are starting to gray and blur between -- was this an account takeover. Was this a cyber attack? Where did the actual break in those controls occur that the funds left the customer's account? So we're starting to really think about that as well.

MEMBER MAUST: Just to add to the cybersecurity discussion and thinking about other risks that might influence the stability and public confidence in the financial system. The availability and growth in access to large language models and other AI tools I think it something that will continue to be either now or certainly in the future an elevated risk for not

just our industry but the financial sector more broadly. And we have access to our traditional tools to protect our institutions.

So that's network operations centers, security operations centers, SIMS, intruding detection prevention systems, plus all the process that typically we'd have either examined through the IT examination process or certainly have implemented internally to protect our individual banks. I do wonder if we're equipped to be aware of what are the tools that are coming down the pike that we can have access to, to combat AI-driven cyber attempts, whether they're brute force or there's social engineering like we see with account takeovers. I think taking a more active role, but having the tools rather than -- right now, we're left with hiring more people and specialists to try to identify and combat that.

So it would be great, each of us individually probably don't have the capacity

necessarily or knowledge to find out what are those tools. Maybe it's a coordinated effort we could undertake at some point.

MEMBER DEVAUX: Just a quick comment. I'm sorry. We're going to take about fraud later, right? Okay.

MS. PEARSON: And we can have some conversations over lunch. And then we have some time to talk about fraud a little bit later if you don't mind. So at this point, I want to thank the current panelists and invite Jay Snipes who is the section chief for the Office of Minority and Women Inclusion up to the table.

CHAIRMAN GRUENBERG: Thank you all. That was a terrific discussion.

MS. PEARSON: Welcome, Jay. So Jay is here and he will discuss our financial institution diversity program. The floor is yours, Jay.

MR. SNIPES: All right. Hi, everyone. Thank you, Nikita, for the introduction. So it

looks like I'm following a lively discussion. So hopefully we'll change it up here a little bit.

So again, thank you for the introduction, Nikita, and the opportunity to really join you all today to talk about the Financial Institution Diversity Self-Assessment Program. I'll say this. Looks like I may be a little bit before lunch.

So hopefully, this is not boring. But I will tell you this. I will make sure that I'm brief, but I'll make sure that we're detailed. And hopefully, I'll provide some information that's helpful.

And I had one -- I was dropping off my daughter at school today. I had one advice that she gave me. She said, don't be boring. So hopefully that doesn't happen.

She gave me two 9-year-old jokes. So hopefully it doesn't come to that and I can spare you that. But let's jump into it.

So we'll go back to the first slide,

to the introduction right now before we get to that other slide. But for this discussion, I will be providing the committee the background information on the FDIC's Diversity Self-Assessment Program. And then following that, I will lead into a discussion about how we can help you all in participate and leverage the resources that FDIC and OMWI has to support you through your submission process.

But also I would like to say this as part of the presentation I would like to get your feedback on how we can continue to encourage institutions to participate in the program. And there will be time for questions and comments if you have any of those at the end as well. So we'll remain on that slide.

So what you see on the slide here, we're going to talk a little bit about the Dodd-Frank Act and why we're even doing the assessment. We'll give you a little bit of background before we just jump into the

assessment and what we do as a program here in OMWI. So Section 342 of the Dodd-Frank Act was created in 2010.

The act required that each agency establish an Office of Minority and Women Inclusion most commonly referred to as OMWI. Most people hear it as OMWI. But the act also required that the OMWI directors develop standards to assess diversity policies and practices of the entities that they regulate.

But in 2015, FDIC along with the other regulators issued a joint policy statement that contained standards that provide the framework for financial institutions to assess the financial diversity and inclusion efforts and policies and standards. But the standards they identified five key areas. And those standards focus on organizational commitment, workforce profile, employment practices, procurement, and business practices that focus on supplier diversity, you'll hear more about that, practices

to promote transparency of organizational diversity and inclusion and an introspective entity self-assessment.

So that's a little bit of the background. I won't bore you anymore about the Dodd-Frank. We won't talk more about acts in there, but I will say this.

OMWI understands that every organization has their own unique culture. They move at their own pace, a different pace when it comes to diversity and inclusion. There's a lot of different impacts that can impact your level of pace when it comes to implementing diversity, equity, and inclusion.

However, we also believe that it's important that we understand the landscape of how institutions implement diversity, equity, inclusion, and accessibility, or DEIA. And I think that's an important thing because we want to understand what's happening in the banking industry around that and what are your peers

doing in identifying gaps in those situations as well and opportunities to improve and continue to further on. But I'll say this.

A lot of people ask, why are we doing this? There have been several studies around this, around DEIA and the value of diversity, equity, inclusion. I recently read an article from 2019, maybe a little bit dated, but I got another one for you.

But in 2019 that said 75 percent of companies that utilize front-line decision-making teams that had a culture of diversity and inclusion, they exceeded their financial targets. That was a Gartner study back in 2019.

But in 2022, I recently read another article as I was kind of preparing for this presentation. And it talked about that in diverse and inclusive companies, they had - their employees were two and a half times more productive as well as they earn two and a half times more -- correct that. They earn two and a

half times more per employees and they were 35 percent more productive. Sorry for the slip up there.

But the point is -- that whole point of the thing that is there is value in doing this and understanding where you are in your DEIA journey. And we want to help you with that. And that's part of our assessment process as well is understanding where the industry is. Next slide, please.

So what you see on the screen here is the reporting period communications. This is - What we'll talk about here is how the FDIC and how OMWI communicates with financial institutions, communicate with you all about the diversity self-assessment in that reporting period. And we kind of go down the list in the screen here of the different avenues that we take.

But I will say this. Although the policy focuses on institutions that have entities

over 100 or more employees, we do encourage that all FDIC-regulated entities conduct a self-assessment and voluntarilyshare results. One of the things that we ask is that we want to identify patterns and trends and things going on and provide that information to you all.

We create a report the end of each year that shows that industry report. And we use that data. So we need as much information as possible, right? We don't want to build the report off a subset of data.

So we are looking and trying to encourage more participation. So I'll say this. The 2023 reporting period of communication will be issued soon. But I will say this. The FID-SA portal, the Financial Institution Diversity Self-Assessment portal is open today. And the institutions can go and start filling out their assessment for their previous year. Next slide, please.

So I quickly mentioned the portal.

And maybe you're, like, what is the portal, right? So let me talk a little bit about the portal.

So the OMWI developed the FID-SA portal to streamline the submission process. One of the things we wanted to do is we wanted to make this process easy for everyone and as seamless as possible. The application allows for multiple users to work on the self-assessment.

We understand not everyone is single threaded. So we allow more people to be able to access the assessment. You're able to view previous submissions, so you're not trying to do a guessing game about what you did last year and things like that.

We also allow you to add and review supporting materials and to print a PDF copy. But one of the things that we've also identified to make things easier is we have allowed you to update the responses from the previous year. And what that has allowed you to do is now you can go

and make updates.

So now you kind of have a baseline of where you were last year, and you can make updates. And we have seen great strides and that kind of streamlined the process in reducing the submission time. But we don't leave you to your own to kind of figure out the FID-SA portal.

We actually do a lot of things to try to support you. And that's part of our technical assistance. And so what you'll see on the screen here is part of our technical assistance effort.

In OMWI, we develop multiple instructional videos to kind of help you all through the process and help your staff through the process as they go through this. So again, there are videos. They're on our YouTube channel.

And they cover such topics as how to register and log in. As you'll see on the screen, how to submit the assessment, how to copy a prior assessment as we talked about to make the process

a lot easier. And one of the things that you can submit your own forms.

So we also acknowledge that there are a lot of requests as well for assessments and things. And so we also walk you through the process of how you can submit your own form. And we can work with you all on that as well. Next slide, please.

So in addition, one of the things we wanted to do is we want to meet people where they were and meet you all when it comes to filling out this assessment. Again, we understand videos are great. But it doesn't really have -- if the video isn't actually addressing your particular problem, you're still stuck looking at a screen figuring out what you can do.

And so what we wanted to do this year, last year what we are going to be doing this year. We're going to be having multiple sessions of office hours -- what we call our office hours. And during those sessions, OMWI will provide

technical assistance -- the right technical assistance. And they will be virtual.

We walk through things about how to access the FID-SA portal. We conduct a walkthrough of the application. And there's also an opportunity for financial institutions and your staff to ask questions.

And this is actually great feedback. And if you're not able to join those sessions, we publish those sessions as well because we understand that most people have a lot of the same common questions. And that's why we create the videos. But we also publish those as well for you to reach out to us. And details about the upcoming office hour sessions will be coming soon. We'll publish those in the near future. Next slide, please.

So we talked a little bit about how to get started. There are multiple sets of resources that we've also provided as well. Because like I said, we have technical

assistance.

We're going to be directly providing you support. But we also have a lot of links in our website that we actually go in and look at as well. So as part of that, those support resources to help you with your assessment, is -- I will say this - it is important that you all identify your FDICconnect coordinator and make sure that information is up to date.

That will be our main contact and primary contact for us to be able to help you with your assessment, if you have any questions, and also for us to send reminders of things of that as well, even though we do send multiple reminders out throughout the year. But if you have any concerns or any issues about getting started, the first link that you see in the slide, that will walk you through that. But I'll tell you this.

Don't worry about trying to do the link. If you have any questions, you can reach

directly out to the FID team. Like, we're here to help you. That is our responsibility is to make sure that this process is easy, seamless, and we can address any questions that you have.

So we're here for you. We're here to support you. And you can reach us at bankdiversity@fdic.gov. And the information is on the screen as well. Next slide, please.

So hopefully I'm not due for jokes. I'm trying not to bore you. So I'm trying as, we're going through this. I'll do my best to try to get through this, but we are on the last slide.

So we can kind of move to questions. But prior to the meeting, we did send three probing questions. And as I said earlier in the presentation, we are interested in your feedback. Our goal is to get as much participation as we can.

And I'll say this and I'll go back to a statement to say that I really want to say that this assessment is voluntary. The results are

not part of the financial institution supervisory compliance or Community Reinvestment Act rating. Like I said, it’s strictly voluntary.

But we do hope that you all take advantage of it. And like I said, I want to keep repeating this. As more institutions participate, we will have more information to give you all, promising practices, and trends.

So despite it being voluntary, we do hope that you all take advantage of the opportunity to provide this information for your peers. But I do want to leave you this and this is very important. We do not publish direct information.

We only publish the assessment results in aggregate. No individual bank information is ever provided when we do this information. And I know there has been concerns, just in my speaking with different organizations.

And it is an aggregate. So we're not going to utilize this information for anything

else but providing the assessment results at an aggregate level. So as I mentioned, we're interested in your perspective.

As I come to a close, I will say thank you for your time. I appreciate the head nods. It's always encouraging as we go through. Hopefully, it was connecting. But at this point, I will open the floor for any questions or comments from any of the committee members.

MEMBER DEVAUX: I'm going to just make one. I don't know what the participation level is. And I think I can speak for everybody in this room we understand the value of this.

But we never hear about it from the examiners. Obviously, they don't examine for it. There are a lot of things they do examine for, and we tend to focus on a lot on those things.

So I wouldn't take it personal that we don't participate or a lot of others may not participate. But it's one of those things we'd like to try to get to it. But everybody is so

busy all the time. And there are things that we have to -- we know we have to do. But we all in here know how important this is.

MEMBER DRENTLAW: I would say last year was the first time I ever had heard of it at one of these meetings. And I think the deadline was really close to when we were here. I'm going to echo there are so many reports that we are mandatorily have to complete that to add something else right now is difficult.

I don't know if there's a list of questions. I was just looking if there were, like, questions you can prepare online or even advertising, like, about how long it should take would probably be helpful. Because if it's five to ten minutes, that's one thing. If it's three to five hours, that might be a whole other thing. Or maybe there's a shorter one for the non-mandatory institutions that we could address if it's a longer time commitment. That might help in participation too if it could get shortened.

MR. SNIPES: So Anita and Lloyd, correct? Great points and I'll say this. We do understand that. And that is a common -- that's been addressed.

But one of the things that we can say is, is we do understand that there's already a lot of reports that you all do. And our staff is very flexible. So we're willing to work with you all and your coordinators.

And if there's already a document that you're using that has a lot of this similar information, we're definitely open to considering that as well. So we don't want you to reinvent the wheel or spend a lot of time. Some of the things may not be one for one.

But we do want to get the process started. And some of that information will help us with some great analysis regardless if it's a one for one on our assessment. So I will say this. Please just reach out to us and we can coordinate with you all and see what information

is already out there that we can utilize and that we can leverage to support you all.

And then if not, we can also take your feedback. I think that was great feedback about how to maybe have a shorter one for those that are getting started. But we also for those who've already done it as I mentioned, you can also update the information. That'll help it to go a lot faster. But I do think those are great points. And we're doing our best to try to be as flexible as possible for those who have a lot of other things on your plate, which probably is everyone at the table.

MEMBER SHOEMAKER: Thank you. And quick comment. After our last meeting, I went back to my bank and I said I'm going to do this. I'm going to complete it. We're under 100 employees.

And I got through the first part quickly, our employees, our data. Where I got bogged down was more the third parties and the

vendors, things that I had to gather the information. And at some point, I did have to pass it off to somebody else because just the time consuming.

So I think that's a great comment. We all want to help and we understand. And I think this is wonderful. But we do affirmative action plans and we do vendor management. And I think as time goes on, we will get better at gathering the information. Now it's kind of going to an empty space and having to research a lot of the things that you're requesting.

MR. SNIPES: Okay. And that's a great point. And I'll say this. That can be difficult for a lot of organizations to have all that information.

And we understand. And you can submit the information without having everything complete. That is an opportunity as well. And we may even reach out to say, hey, we noticed that this wasn't complete. How can we help you,

for the next year as well.

But you mentioned the affirmative action plan. And I'll go back to my comment earlier. We do recognize that there are a lot of other plans out there. And we may be able to leverage those for your submission this year.

And that's able to be worked out. Then we'll utilize that. And if there's a few questions that we have, we may reach out to you and we may work on how can we better update our systems or allow you for better time to plan and update that for next year.

But again, we are open to those opportunities because we want to get the information. And we're not going to be stuck on focusing on the portal. We want to get your information. We want to make this process easier for you.

MEMBER SHOEMAKER: Wonderful. Thank you.

MEMBER MAUST: Just one additional

comment. And by the way, after the last meeting, I also went to the assessment and went through every single question just to see is it something we could readily complete. And it was -- when you got to certain questions where it was really data heavy, that required quite a bit of involvement of staff.

So last time we were talking about this actually. And how do we get from point A to point B with the industry. And I think the suggestion -- actually, I think Anita brought it up -- of having -- it may not be feasible.

But a more high level just to get somebody engaged. So a bank engaged in the process and recognizing, okay, these are the categories we're going to start to focus on. We'll do the deeper dive in part 2. Or breaking it up into sections, so maybe it's about the profile of the bank and then it’s the profile of the vendors.

But it can be completed in distinct

forms because what I'd love to be able to do as a bank and I think other banks might feel the same is benchmark myself against either peers or against the ideal peer profile to just know where are we and what do we need to do. Because we might have a general feel for that. But it's a bit abstract right now. And so I think that the ability to benchmark gets us motivated to maybe address the gap.

MR. SNIPES: That's a great point. I don't have anything else to say besides that's a great point. And especially the part about the ideal peer. We can't do specifically your peers because again we are at an aggregate and I want to make sure I report that.

But I do think the ideal peer situation, we can kind of see where you are. That is our goal. And so we can make that part a lot easier. We'll definitely do that. So great point, Trey.

MEMBER CROCKETT: You know, one other

comment. If there's a way to increase the awareness about this. Because, like, someone mentioned, I'm embarrassed to say I didn't know about this until I read this packet.

And I asked my other management team. I said -- and other members -- do you know anything about this? Are we doing this? And they said, no, this is -- they had to do some research.

So I don't know if there's just a way to increase awareness about it. I think maybe that would increase participation. It's on our radar now to get it done.

MR. SNIPES: Okay. We'll definitely take that down as a note. Thank you, Carolyn.

MEMBER DRENTLAW: So I hate to say it because I know that you put emails out and social media and stuff. I'm almost getting to the point now that I'm getting so many emails that if I get a physical letter I actually pay attention to it more which seems completely backwards. But when

you get 200 emails in your inbox a day, it is so hard to manage.

And there have been a few things that I'm, like, I've gotten something physical. And I'm, like, oh, and I put it on my desk. And I know it seems really old school and I'm totally in the realm of using a laptop for all my notes and stuff. But it's just -- it's gotten so hard to maneuver through all of the stuff that we get.

MEMBER MAUST: So what's your initial response when a letter shows up that's from FDIC?

MEMBER DRENTLAW: I open it. I would open it.

MEMBER MAUST: Yeah, it's a little scary sometimes. I would maybe suggest also, just asking during the examination process because it's a great point that it definitely gets on the radar when that's the case. But you're absolutely right. It would get my attention if a letter shows up.

MR. SNIPES: All right. You're on the

hook. We may give you a letter before you walk out the door today.

(Laughter.)

MR. SNIPES: Any other questions, comments? Thank you for your time.

CHAIRMAN GRUENBERG: Tell your daughters you did good.

MS. PEARSON: Thank you very much, Jay. And so we will wrap up. I appreciate the feedback. Very good feedback. We appreciate that.

So as Jay walks away, I would like to welcome up Betty Rudolph, Director of the Office of Minority and Community Development, and Warren Huang who's already at the table. Yesterday we had our meeting of the Minority Depository Institution Subcommittee. And they are here to give us a brief of that meeting.

MS. RUDOLPH: Thanks, Nikita. I just wanted to briefly remind the committee here that the Minority Depository Institution Subcommittee

was established by the FDIC under the authority of the Federal Advisory Committee Act. So the subcommittee is actually reporting to you, not to the FDIC.

So any recommendations they make, they would bring to you to bring to FDIC management. So we have three goals for the subcommittee. The first is to serve as a source of feedback for our minority and depository institutions program and our work to fulfill some statutory goals that we have for minority depository institutions. And we also like to provide a platform to promote collaboration, partnerships, and best practices.

And finally, to identify ways to highlight the work of these institutions and their communities. And we have nine MDI executives that comprise the subcommittee of all types, Hispanic, Native American, African American, and Asian American MDIs and a range of business models, sizes, and geographic mix. So in addition to those nine executives advising

this committee, we have four MDIs on this committee.

And I think you all self-identified today, so Dom, Lloyd, Warren, and Robert James. And Warren also serves on the MDI subcommittee as well as this committee. And he's going to give us the readout from yesterday's meeting. Warren?

MEMBER HUANG: Thank you, Betty. At this time, the subcommittee has no recommendations for the FDIC. But the subcommittee did want to give a brief recap of yesterday's meeting. So yesterday, we received a presentation similar to today's on current economic banking conditions and financial performance indicators.

Similar to today, we also responded to questions about funding, interest rate risk, credit risk, and the economy as a whole. And then we received an MDI spotlight where we heard about two Native American banks headquartered in different states, plus CDFI loans – Native

American CDFI to fund a new $45 million tribal healthcare center on tribal land in northern Wisconsin. So the complex capital stack included new market tax credit investors.

The total loan size is about $20 million which is larger than the legal lending limit of the two banks. Together, they were able to meet the needs of the tribal borrower and create meaningful income for their banks and create a larger health center to really meet the needs of the community. So the FDIC is going to place the video on its website. So I encourage everybody to watch it. Other CDFIs, MDIs, tribal organizations can learn about the collaboration.

And then we also had several briefings from FDIC staff on the supervisory topics that we're discussing today. And lastly, we had a briefing on recent initiatives of the Office of Minority and Community Development Banking and provided some feedback on their program operations. And so that's the conclusion of the

report. If you have any questions before lunch, we'll be happy to take them.

(Laughter.)

MS. PEARSON: All right. Thank you, Betty. Thank you, Warren. So we will break now for lunch. We will return at 1:00. For you all to know that before we come back from lunch, we will take a group photo.

Shannon will direct us. And in addition, Lloyd, I wanted to let you know when we return, we will have someone from our cyber and financial crime section here so we can continue the discussion, so I wanted to make sure I circled back for that. All right. Thank you all.

(Whereupon, the above-entitled matter went off the record at 11:34 a.m. and resumed at 1:05 p.m.)

MS. PEARSON: Welcome back. To start the discussion, we have Tom Lyons from the Division of Risk Management Supervision. Tom is

the associate director of the Division of Risk Management Policy Branch. Tom will cover the interagency effort to reduce the regulatory burden, guidance on managing commercial real estate concentrations, and the proposed revisions to the statement of policy on bank merger transactions.

Then we'll have Lisa Arquette, and Lloyd McIntyre, and Mike Benardo also from the Division of Risk Management Supervision. Lisa is the deputy director of operational risk. Mike is associate director of the anti-money laundering and cyber fraud section. And Lloyd is the examination specialist in the cyber fraud and financial crimes section.

Lisa will cover the customer identification program rule and beneficial ownership, and Lloyd will cover check fraud. And now I'll turn it over to Tom.

MR. LYONS: Well, thank you very much, Nikita, it's a pleasure to be back with you again.

I have seen you a few times in the past couple of years, it's always a pleasure to come and speak with you, so thank you. So, I have a few things to go over with you, as Nikita mentioned. The first thing really gets into EGRPRA.

So, this is every ten years the FDIC, Fed, and us, OCC, we get to look at all our rules under EGRPRA. So, we initiated the third decennial EGRPRA review, and are encouraging all stakeholders to participate in the review, and submit their comments on outdated, unnecessary, and unduly burdensome regulations.

The FDIC has also opened a hearing about any of our processes that could be more efficient to ease burden. So, the EGRPRA requires the FDIC, the OCC, and Fed to categorize our regulations by type, and publish categories at regular intervals in the Federal Register seeking public comments on whether the regs contain outdated, unnecessary or unduly burdensome requirements imposed on institutions.

We do that every ten years, publish in the Federal Register a summary of the comments that we receive, identifying and discussing the significant issues that are raised. And then within 30 days of publishing that summary of comments, we submit a report to Congress on any significant issues raised by the public with the relative merits of such issues, and whether the agencies have the ability to address the reg burden through regulation, or if some of those things might need a legislative action to fix.

Also, we will take action too to eliminate unnecessary regulations to the extent that such action is appropriate. So, appropriate -- to facilitate the review, the agencies divided the regulations into 12 different categories. And are first soliciting comments on their regulations in three categories, so that's applications and reporting, powers and activities, and international operations.

Comments on the relevant regulations

will be accepted 90 days after publication in the Federal Register. So, for this first batch they're due on May 6th, that's this week, the coming week. So, over the next two years the agencies will request comment on the regulations in the remaining categories, asking the public to identify those regs that they believe are outdated and need to be looked at.

Agencies also plan to hold outreach meetings where interested parties may comment on applicable regulatory requirements directly to the agencies. Information about the outreach meetings is going to be publicized as the details are finalized, and we're still discussing with our partners at the Fed and the OCC on how to accomplish that.

So, that's a quick, very high level update on what we're doing for EGRPRA. So, before I move onto the next category, if I have any comments or questions? I know my topics are in a variety of different places.

MEMBER DEVAUX: Quick comment. Is UDAP included in -- I'm just kidding.

MR. LYONS: As he says, as the regs come up, please comment. Okay, so my next topic is an advisory that we had issued in December, this past December, and it's on CRE concentrations. So, this advisory replaced a 2008 advisory on managing CRE concentrations in a challenging environment. We had issued that previously in March of 2008.

So the new advisory, it doesn't communicate any new risk management principles, however, it does update on those from the 2008, and builds upon those and previously issued guidance. So, as you can imagine back in 2008, we were just going into the past crisis, and it really highlighted a lot of issues that we were experiencing then such as issues related to ADC lending, the housing market was experiencing a slowdown, liquidity - credit market liquidity had deteriorated, lending terms had tightened,

residential markets in the U.S. had been overbuilt. So, that advisory kind of addressed a lot of the issues that we're seeing in the CRE lending concentrations.

So, in the current environment, so recent weaknesses in the current environment, in the fundamentals related to various CRE sectors have increased. The overall attention and concern for us as state non-member institutions with large concentrations of CRE loans, CRE investment property cap rates have not kept pace with recent rapid increases in long-term interest rates.

Which leads to concerns about general overvaluation and underlying collateral. The vacancy rates are rising, most notably in the office sector, but also in multifamily. Office attendance is approximately 50 percent of pre-pandemic levels as telework has been kind of a way of life for us now.

In addition to large amounts of

available space, high levels of office loans and office leases will be maturing in the next few years, so there's a lot of stuff coming at us. A refinancing of office and multifamily loans could be challenging in the environment of pressurized -- rent growth, high interest rates, lower property values, particularly for those institutions with CRE concentrations in office and multifamily.

FDIC continues to be watching these institutions with concentrated CRE exposures, because they may be vulnerable to real estate downturns. If we could move to the next slide please? The FIL highlights that capital provides institutions with protection against unexpected losses, particularly in stressed markets.

As market conditions warrant, proactive directorates and management take steps to increase capital, and supplement significant CRE concentrations, and mitigate the impact of potential loss. Institutions are expected to

determine their ACLs in accordance with GAAP and regulatory reporting instructions, stated policies and procedures, and management's best judgment.

So, institutions with significant CRE concentrations are advised to consult with recent supervisory guidance, particularly the interagency statement on allowance for credit losses, which we issued in April of 2023. So, next. So, consistent with the safety and soundness in real estate lending guidelines in your appendices, institutions should maintain prudent lending standards and credit administration practices that consider the risks of material C&D and CRE concentrations.

Including getting updated borrower information. It also includes touching on management information systems that provide board and management with relevant data on concentration levels and related conditions, including concentration of market segments.

Portfolio loan stress tests and sensitivity analysis can be an invaluable tool in identifying and quantifying the impact of changing economic conditions, and changing loan level fundamentals on asset quality, earnings, and capital.

Additionally, the FIL also highlights liquidity and funding risks, since they may be compounded in a challenging interest rate and economic environment. And it's important for institutions to have comprehensive management processes for identifying, measuring, and monitoring, and controlling liquidity and funding risks.

So, institutions with overall credit risk management processes that reflect consideration of the principles of the 2006 concentration guidance are better positioned to manage through adverse economic environments. The principles of the 2006 CRE guidance remain relevant, particularly in a challenging environment, and particularly for institutions

engaged in significant CRE lending strategies.

You know, to help them remain healthy and profitable while continuing to serve the needs of the community. And so as with any asset exposure, significant CRE concentrations can lead to losses and capital deficiencies in a stressed environment.

FDIC’s examiners recognize the challenges facing the institutions in the current CRE environment, and will expect each institution's board and management to strive for strong capital and appropriate ACLs, and to maintain attention on their credit risk management practices.

So, in a quick rundown, that's the message that we're trying to communicate in the FIL on CRE concentrations. So, before I move to the next topic, do I have any questions or comments? All right. So, I'm going to talk a little bit about mergers. So, a big priority for the FDIC has been updating the bank merger review

framework, it's been important for us for quite some time.

The Bank Merger Act creates a statutory framework requiring regulatory approval in connection with a variety of transactions. And so, the FDIC has a special role within the framework, in that we have exclusive jurisdiction for looking at any merger transaction where an IDI and a non-insured institution get together.

For transactions between two insured depository institutions, the Bank Merger Act, or BMA, divides responsibility among the three banking agencies, so the FDIC has jurisdiction there to act on such transactions in cases where the resulting institution is FDIC supervised. So, in order to implement our responsibilities under the Bank Merger Act, the FDIC has regulations, we have issued a statement of policy, and we've published our applications procedures manual.

So, further, we get together with the other agencies, there is an interagency application form which is available, which includes a supplemental section, which is specific to the FDIC to gather the information that we need to assess the application. So, March of this year our board approved the publication of a revised statement of policy for comment.

And we published that in the Federal Register for a 60-day comment period, and comments are due June 18th of this year. The revised statement of policy updates, strengthens, and clarifies the FDIC's policies related to evaluation of bank merger applications. The current SOP was last published in 1997 for comment.

And then we did revise it in 2002 and 2008 for some statutory updates that weren't out for comment, and that included incorporating the anti-money laundering statutory factor, and various other amendments due to the Financial

Services Regulatory Relief Act of 2006. The revised SOP reflects numerous regulatory, legislative, and industry changes that have occurred over the past 27 years, since that last proposal was put out for comment, including the adoption of the financial stability factor as required by Dodd-Frank Act. It also reflects a consideration of the comments in response to our March 2022 request for information on mergers. And that RFI solicited comments regarding the effectiveness of the existing merger framework of laws, and rules, and regs, and guidance, and practices that have helped us meet the statutory requirements for the Bank Merger Act.

So, next slide. So, a goal for the proposal is to improve the transparency and clarity for merger applicants, so that they can have as much information about our review -- of merger applications before they apply. The revised statement of policy is a principles-based overview that describes how FDIC administers its

responsibilities under the Bank Merger Act.

The proposal also focuses on the scope of transactions subject to our approval. The FDIC's process for evaluating applications, and the principles that guide the FDIC's consideration of the applicable statutory factors as they set forth in the Bank Merger Act. While historical performance provides insight into the evaluation of these factors, the revised SOP affirms that the evaluations will be forward looking.

The revised SOP addresses each statutory factor separately, and describes the expectations for processing the filing, including conducting pre-filing meetings, publishing the proposal, and submitting a complete application to the FDIC. The proposal also highlights other pertinent matters and considerations, including the unique aspects of applications for non-banks, operating non-insured institutions, and non-traditional community banks.

Next slide please. The revised SOP incorporates and builds upon the description of the analytical considerations for each of the statutory factors, which are individually addressed. And includes a declarative statement to highlight the FDIC board's expectation for the evaluation of each factor.

And the next couple of slides just highlight the statutory factors, so next slide. So, with respect to the evaluation of competitive effects, the banking agencies coordinate with the Department of Justice when evaluating a merger's effects on competition, and the FDIC continues to collaborate with our fellow agencies as we consider the appropriate framework for reviewing merger transactions.

When evaluating the competitive effects of a proposed transaction, the FDIC expects the resulting institution will operate in a competitive environment, where consumers would retain meaningful choices. And this evaluation

includes all relevant financial service providers that compete in the identified geographic and product markets.

The assessment of competitive effects considers concentrations beyond those based on deposits. As appropriate, FDIC may consider concentrations in any specific products or customer segments such as the volume of small business or residential loan originations or activities requiring some specialized expertise.

So, in the RFI that we had put out, there were commenters that suggested that FDIC should have a separate analysis for the competitive impact in rural areas, minority markets, or low- to moderate-income communities when relevant. And while the proposal does not specifically address the analytics of rural, minority, and low- to moderate-income communities, it does affirm that the FDIC will use a geographic market with a scope that is suited to the products or services offered or

planned.

In cases where divestiture of branches might be necessary, the revised proposal clarifies that the divestitures are expected to be completed before consummation of a merger transaction. Further, the proposal establishes a policy against entering into or enforcing non-compete agreements with any employee of the divested entity.

Next slide please. The assessment of the financial resources evaluates whether the resulting IDI will reflect sound financial performance and conditions following consummation. The evaluation of managerial resources assesses management's capabilities to administer the resulting IDI's affairs in a safe and sound manner, and its ability to effectively implement integration plans and strategies for absorbing the acquired entity.

The evaluation of future prospects assesses whether the resulting IDI will be able

to operate in a safe and sound manner, and maintain an acceptable risk profile on a sustained basis following consummation of the merger. Next slide please. The revised SOP articulates the evaluative considerations used to assess the effectiveness in combating money laundering.

And introduces terms and abbreviations that are used following the adoption of the Anti-Money Laundering Act of 2020. The proposal emphasizes the FDIC's expectation that a merger, subject to its approval, results in an institution that is positioned to better meet the convenience and needs of the community to be served than would occur absent a merger.

And so, the proposal explains that this may be demonstrated in a variety of ways, including demonstrating through higher lending limits, or greater access to products and services, facilities, introduction of new or

expanded products, reduced prices, and some other means. Evaluation will also consider public input.

So, to that end, the proposal indicates that our general expectation to hold hearings for transactions that would result in an institution that exceeds $50 billion in assets, or for which a significant number of CRA protests have been received. So, we may also hold public or private meetings to receive input on the transaction.

Next slide please. The discussion regarding the risk to the stability of the United States banking and financial system generally reflects the FDIC's approach since the factor was added to the Bank Merger Act. The assessment of the stability factor focuses on the size of the entities involved, availability of substitute providers, resulting IDI's degree of interconnectedness with the financial system, the extent to which resulting IDI contributes to the

banking system's complexity, and the extent of the resulting IDI's cross-border activities. So, although size alone will not be dispositive, the revised SOP indicates that a resulting institution with $100 billion or more in assets is more likely to present potential financial stability concerns, and thus will be subject to additional scrutiny.

So, the bank failures of 2023 kind of underscore the risks that banks with assets over $100 billion may present. So, next slide please. So, the revised SOP would provide added clarity for the public and staff regarding the evaluation of bank merger transactions, and enhance the effectiveness of the FDIC's framework in meeting the requirements of the BMA.

The revised proposal and amended FDIC supplement to the application are significant steps in the process of updating our approach to evaluating transactions subject to the approval of the Bank Merger Act. And the changes to the

statement of policy are intended to positively affect safety and soundness, financial stability, community accountability, and competitiveness in the banking system.

So, publishing the SOP for comment gives the FDIC an opportunity to benefit from public input, and like I mentioned in a separate federal register notice, but at the same time, the FDIC, as part of its obligations under the Paperwork Reduction Act, also invites comments on the application for the FDIC's supplement.

And we look forward to receiving and evaluating comments on the proposal, and the FDIC supplement, which will help us going forward. And we'll take that into account before we finalize. I think I've spoken way too much, so I'm happy to take any questions, thank you.

MEMBER SHOEMAKER: Mr. Lyons, forgive me for going down this path, and I appreciate that it's still open for comment, but my comments are really directed towards page 12 and page 14

in the slides, that the Bank Merger Act, credit unions, as you know, are swallowing up banks, and the proposed language takes into consideration the competition.

But it's hard for us to compete, even with bank mergers, when the credit unions are there. And the other thing is that, in my mind, I'm digesting this information, the CRA impact, when banks are merging with other banks, we're still obligated to meet all of our CRA obligations, but yet credit unions are not.

So, it's not a question, I'm not going to pose that to you unfairly, but it's just a statement that it seems like banks have all the scrutiny, and all the regulatory burden, but it seems like we're reducing competition by pushing the number of banks to decrease and be bought by credit unions. And so, the competition is really going to have an adverse intention of what the FDIC envisions.

MR. LYONS: Well, thank you for the

comment, I definitely appreciate that.

MR. PEARCE: Now I have to push a button. I'm the comic entertainment for the day's presentation. So, yeah, I just wanted to -- your comment, one of the things I wanted to highlight is under our regulations, it's sort of an odd thing, but our regulations, so under the Bank Merger Act, credit union is actually considered a non-insured institution.

And so, we review credit union mergers when they acquire a bank, and so and it's the same statutory standard for convenience and needs. So, when we do that review, we try to do that same evaluation. But as you point out, there's not a CRA record for how the credit union has been serving their customers, and so it creates some challenges in the review.

But it is something that we do do when we have those mergers, and we evaluate it just as rigorously as we do any other merger to try to determine whether it's going to meet the

convenience and needs of the community after the merger.

MEMBER SHOEMAKER: Thank you for that comment.

MR. PEARCE: I'm not quite sure it was worth all the work to get me up here, but.

MEMBER MAUST: I had a question in reference to the anti-competitive effects. Just out of curiosity, I saw: establish a policy against entering into or enforcing non-compete agreements. I'm curious does that extend, and I know it's not a non-compete provision, but does it extend to non-solicitation provisions, or agreements, or is it just non-compete for the individual employee in terms of scope?

MR. LYONS: I'd have to get back to you on that. I know it's focused on the issues of folks not being able to move other places and get employment is really where the target is.

MEMBER MAUST: Yeah, and a lot of states don't allow those to be enforceable too,

so that'll be consistent with what we're used to in practice, so thank you for that. And a non-solicitation would be of concern, so that's why I'm -- I'll have to look at the proposed guidance to see if that's in there.

MR. LYONS: Sure.

MEMBER MAUST: The other question I had was -- well, I'll ask that in a bit, but it was more kind of broad. Well, I'll go ahead and ask it. I've heard anecdotally from attorneys, so law firms that are involved in a fair number of mergers, at least historically, not as many now, as well as investment banks, that the process for -- and I don't necessarily like to see consolidation in the industry, but I just wanted to ask the question.

That the process for approval has extended significantly, and I don't know that it was pointed at one particular supervisory agency, but I was curious whether you see the this impacting either positively or negatively, that

window of time from submission of application to an actual response.

My guess is, I'd be hopeful that it would actually facilitate it, because it looks like the objective is to get to a completed application that is complete. As opposed to getting it returned, and questions and comments, but I just wanted to pose the question.

MR. LYONS: Sure, and I think that's an accurate way to kind of think about it, because we're trying to update the whole framework, right? And make it more clear, more transparent, and make it clear, okay, what are we looking for? So, a better understanding of what those are, so that when we do get the applications that come in, they are complete.

And it avoids some of that back and forth as you kind of alluded to. So, yes, a goal of this is to, the more of that information that we need, that we get up front, and we always encourage conversations even well before, if

you're thinking about this, talk to us, and we can walk through some of those things, and questions.

Also with the supplement for the application, there's additional information that's there that will help us, help all of us get there. What exactly are we looking for, if everybody understands what that is, it helps with the process, any questions, give us a call right away, and we'll work that through.

So, yes, ultimately we'd love to make these things as short as they can, but it's also going to depend a lot on the complexity of the transaction.

MEMBER MAUST: Thank you.

MR. LYONS: Sure.

MEMBER HORTON: I have a comment on this, but as we see more credit unions acquiring banks, do you think our legislative bodies are going to be more open to credit union taxation, as we see more and more tax revenue dollars peeled

off, and become never part of the federal or state tax coffers again? So, where is this all headed?

MR. LYONS: Well, I thank you for the comment, and when we're talking about taxation and things like that, that's a comment for the folks up on the Hill.

MEMBER HORTON: I'm just wondering if you thought this was going to have an impact.

MR. LYONS: I can't answer that, I just don't know.

MEMBER DEVAUX: I would make one comment. Alex Sanchez, who was CEO of the Florida Bankers Association, actually relocated to Washington for four months for the purpose of getting legislation introduced in order to make credit unions above a certain size taxable. He finally got one Republican representative to sponsor it for 24 hours.

Twenty-four hours later he got a call saying I'm sorry, I can't do it, and they are heavy supporters politically. And no one -- I

always say it's torn between two lovers, we donate to the politicians, the credit unions donate to the politicians, and they don't want to upset either side.

And there is a credit union in the House, actually in the House of Representatives, so we've been beating it forever, but I don't see any movement in that area.

MR. LYONS: Thank you, appreciate it.

MS. ARQUETTE: Good afternoon. As Nikita mentioned, my name is Lisa Arquette, I'm the deputy director for operational risk in the Division of Risk Management Supervision, it's nice to be here. I'm going to address two topics. You probably are well aware of these topics.

One is related to the customer identification program. That's an anti-money laundering requirement that all banks follow, it's not new. And the second will be changes to beneficial ownership collection, who collects it, on what kind of companies, and what changes will

occur for the banking industry.

So, the first one is the customer identification program. That was made effective in the middle of 2003, it's been more than 20 years in place, and prior to that it was a banking practice to collect information on customers before opening an account, so this is not new. But in 2003, banks were required to collect four pieces of information on customers.

Name, date of birth, a physical address, and a tax identification number. You've been doing that for even longer, so it's not new. But what has changed over time is just the way that customers interact with financial institutions, technology, et cetera. And so, FinCEN, the Financial Crimes Enforcement Network, FinCEN is the administrator of the Bank Secrecy Act.

FinCEN issued a request for information and comment March 28th of this year to really explore an issue. They did this in

consultation with the federal banking agencies, the FDIC, the Federal Reserve Board, the Office of the Comptroller of the Currency, and the National Credit Union Association.

Next slide please. So, the purpose of FinCEN's request for information is really to understand one specific aspect of that collection that seems to have changed over time with non-banks. So, I mentioned the tax identification number that you collect from all of your customers before account opening, whether it's a deposit account or a loan.

Third parties are non-banks that are not subject to anti-money laundering requirements have streamlined a process; it's faster, it's easier, and they are collecting less than a full tax identification number, or less than a full social security number, they're collecting generally the last four digits, and seeking the remainder of the digits from another third party.

So, FinCEN is seeking to understand

the risks associated with, the benefits of, and some of the safeguards that have been used when an abbreviated process has been used, and there's not an implication that banks are doing it. It's really when banks possibly are partnering with third parties, the third parties are doing this.

So, really the request for information is seeking information prior to making any changes, and really to understand safeguards that may be in place. Now there's a next, a following requirement after that information is collected, and banks, on a risk basis, have to verify the identity of the individual that they're doing business with.

Again, nothing new to you. However, it's really important to know who you're doing business with, and when streamlining a process, what are the risks, what are the benefits, what are third parties gaining from this, what are the safeguards? So, it's not permissible now for banks to streamline the process, not even if

you're working with a third party.

The information has to come from the customer before the account is opened, and we've seen instances where that hasn't worked. Still, recognizing that there have been changes in how customers interact with a bank, particularly during the pandemic and afterwards, there's a lot of online account opening, and again, that's for deposits.

But then on the loan side, even loan products have changed. And sometimes at a retail operation a customer might get a buy now pay later loan to help finance a purchase, and they're reluctant to provide a full social security number. So, this practice has evolved over time, and I would encourage those of you who have an interest in this, or have experienced maybe challenges with third parties that you're dealing with, to take a look at that request for information.

It's pretty comprehensive, it's

really covering the full groundwork, risks, benefits, and safeguards to understand if a reliable third-party source is used to collect the remaining information, does that really create any challenges that are unknown? Because the last thing anybody wants to do is to make changes that could have unintended consequences.

So, I would recommend taking a look at that. Along with that, and on the same day –next slide, please -- the FDIC issued an advisory to FDIC-supervised institutions, again, reinforcing the requirements to collect those four pieces of information before an account is opened, deposit side or loan side, and then use that information to help form a reasonable belief that you know the identity of the customer.

Nothing new, but we really have seen, particularly post pandemic, some practices that have evolved, and have affected some banks unknowingly. So, we would just again, emphasize the requirements. And if you have an interest in

commenting on FinCEN's request for information, I would encourage that you would go to FinCEN.gov to get that information.

The next topic that I would like to cover would be changes to beneficial ownership requirements that banks have. So, the Corporate Transparency Act was passed as part of the Anti-Money Laundering Act of 2020, and it is threefold rulemaking that will impact banks and reporting companies.

So, currently you must collect beneficial ownership information for legal entity customers, so that you know the true identity of either who is controlling, or who owns 25 percent or more of legal entity customers. The purpose of course, and this is a rule that follows international standards, the purpose is really to understand and prevent the use of illicit actors from using legal structures to launder money in the United States, and just for other illicit purposes.

And so, you've had this rule in place for quite some time, but there's a change, and this is with the Corporate Transparency Act. So, the three rulemakings include beneficial ownership information reporting rule, that became final in 2022. Then there is the beneficial ownership information access rule; that was published in December of 2023.

The next rulemaking will be to make amendments to the customer due diligence rule, because embedded in that rule are the requirements for you to collect beneficial ownership information from legal entity customers. But a couple of the changes that would be interesting to note would be that legal entity customers are no longer the criteria.

It's a reporting company, but it sounds very similar, so it's a domestic company that's either a corporation, a limited liability company, or any other entity that's created by a filing of a document with the secretary of state

or any similar office in the United States.

Or a foreign reporting company, including corporations and limited liability companies formed under the law of a foreign country that is registered to do business in the United States by the filing of a document with the secretary of state or any other similar filing. So, that's a reporting company, formerly referred to as a legal entity customer in the current rule.

So, I flag that because the definition has changed, and the requirements will change going forward. Next slide please. So, reporting time frames, what are they? I can break this down into three different categories. Those would be companies that were formed before the rule became effective. Its effective date was January 1st of 2024 this year.

So, companies formed before that have a full year to get their information into a registry that was created by, developed by

FinCEN, the administrator of the Bank Secrecy Act. And they would go to BOI e-filing, so beneficial ownership e-filing to load that information, and these were for companies that were formed before 2024.

So, the vast majority of the companies in the United States, and to be clear, there are millions of companies formed annually in the United States, so this will be a massive database, it's already quite large. Companies created or registered in 2024 will have 90 days to put their information into this database.

And companies created January 1st of 2025 and beyond will have 30 days to get their information into the database. Very early on, again, this database became live in January of '24, FinCEN had over a million records in their registry. So, the word is getting out, they have a very good public information program.

But I flag this because customers of yours may have an interest in knowing, and really

wouldn't know where to go, so I'll provide some resources in just a moment. Next slides, please. So, what is a reporting company required to provide in this database? The legal name, important, doing business as, a trade name that they might have, a current street address, and principal place of business.

The jurisdiction of formation, whether the United States or some other jurisdiction, the tax identification number of the business, and the beneficial owner of that company. So, it's going to be, again, the name, date of birth, a residential address, and an identifying number. Now, this identifying number is not going to be a tax identification number.

But it will be something like a passport, a driver's license, and something that has an image for security purposes to understand who that beneficial owner is. Again, it's really to help verify the identity. Next slide please. So, access to the BOI registry, who is going to

have access?

There are six different categories. The first is government agencies that are engaged in national security, intelligence, and law enforcement. The second category is state, local, and tribal law enforcement agencies. The third would be a foreign requester that would be on the behalf of law enforcement, a law enforcement agency, a prosecutor, or a judge of another country, or on behalf of a foreign central authority, or foreign competent authority.

There are a couple of additional criteria, but they would have access under certain circumstances. The next would be you, financial institutions. The purpose of your access would be if you have a reporting company, and you need to verify the beneficial owner, which you still will, that information would be hosted, held in that registry, and you could obtain that information, and then verify the

identity.

So, you'll have access to FinCEN's database upon request. You'll get confirmation from the customer, you'll access the information, you'll verify the identity. Federal functional regulators, that would be like the FDIC, the Federal Reserve Banks, the OCC, National Credit Union Association.

The only way we'll have access to that information, it's really protected, it's important to keep that information secure. We'll have access if you have access. So, if you have collected information on 10 customers, 100 customers, and you provide us with a list, then we can have access to information.

The benefit will be that we can just do our transaction testing, compare the processes that you use against that data. But that's the limitation that we have on accessing the information. And the sixth category will be Treasury personnel. Now, there are safeguards

associated with accessing that information, as with all information that FinCEN retains, because there could be some national security implications related to information that is obtained.

And really, this is PII information, it's critical that we keep that confidential, and safe. Next slide please. So, for your own customers that are reporting companies, your commercial customers, where would they go, how would they know this information if they haven't had access to FinCEN's campaign to share the information?

Going to FinCEN.gov, on their main page there is a BOI tab, and it is loaded with resources, very good resources, not only about the rulemakings, which I find interesting, but your customers may not find interesting. What they want to know is just a snapshot, what do I need to report, how do I gain access to this database, when do I have to report it, why do I

have to report it?

And so, if you go to this website, you'll find a number of resources, and in particular the small business resources would probably be useful for smaller businesses that generally are not tracking this type of information, so I would refer you to that for the benefit of your customers. And if you just want a quick snapshot of the rules that are in place already, and changes that will be occurring to the customer due diligence rule.

Now, they have not published their notice of proposed rulemaking yet; they're proposing to do that this year. So, I'd be aware, I'd take a look, comment if you have an interest in that. Next slide please. And again, these are just some of the resources, just to flag -- there's frequently asked questions, there's that small entity guide.

And then there's a very easy, quick brochure that you can print out if you have a

need to do that. So, before I hand over to the next presenters, are there any questions?

MEMBER DEVAUX: I do have one. I know there's a lot of gray area here yet, because it hasn't come out yet, but how are customers being made aware of this, how are businesses being made aware of this, and should the banks play a role? That's the first part. The second part, do you envision down the road that we would not be allowed to do business with a customer that was not registered?

MS. ARQUETTE: Well, the first question, so FinCEN has engaged in a campaign, just an informational campaign working with secretaries of state, so they're working pretty closely with states that license businesses to make sure that they share that information, that it's available, that it's out there.

But not everybody knows who FinCEN is, right? It's a small bureau within Treasury, it's the administrator of the Bank Secrecy Act. So,

I flagged those resources for you so that your customers know. Because right now you would be collecting that information, and you would be updating it regularly, and you will until that rule is changed.

But your customers might not know that. So, again, they have been working with secretaries of states, they have been working with states in other ways to publicize this information, but it's not -- I wouldn't expect it to be uncommon that it would be news to a lot of small businesses that are start ups.

Because again, there are projected to be millions of them annually that start up, hopefully are successful. So, I do think that you could play a role by having a couple of the brochures accessible, or the information available to your customers, especially if they're seeking a loan.

Whatever the relationship is that they're seeking, you could easily get them the

information, and providing that information through the database is very fast. So, it would be just a really quick process for them, I would assume, just based on those data elements. Your second question was can we do business with people if they don't, companies if they don't provide that information in the FinCEN database?

There's not a prohibition written into the requirement at this point, or the amendments to the customer due diligence rule at this point. I think that's a very good question, but I do think that it could be a couple of things. One, a company that simply didn't know the requirement, and so just notifying them, and having them complete that step would be very useful.

Because you'll still be required to verify the identity of the beneficial owner. So, you're going to need information to do that as a starting point, so I think a good education of the customer, just providing the resources,

letting them know where the website is would be a good first step.

Alternatively, could be a red flag, hard to say, but when you verify the identity or go through that process, your own customer due diligence process, you'll probably draw some conclusions that could simply be just a lack of awareness that there's a requirement. It's a good question, thank you.

MR. BENARDO: Also we reached out to our colleagues at FinCEN with the exact same question -- is this one on? And another thing, in addition to everything that Lisa just said that they're doing is reaching out to the SBA, the Small Business Administration, to try to make sure that it's incorporated into their materials that they provide to small businesses.

And also they're working with companies that support small businesses like tax preparers and accountants to get them to try to make sure that the companies they work with

understand the requirements.

MEMBER DEVAUX: Department of Commerce?

MR. BENARDO: I don't know, but that's a good recommendation, so I'll make a note to tell them that. But I do know they're trying to think creatively about ways to outreach to the community we're talking about.

MS. ARQUETTE: Thanks, Mike.

MEMBER RICHARDS: I've got a comment. When beneficial ownership first came out, we hated it because it just slowed up the account opening process. We got used to it, and it seems like this process is just going to make things worse than better, as far as the account opening process, it's going to slow things down.

It's a lot quicker just to fill out the form than it is to try to see if they registered on FinCEN, and if they haven't, try to counsel with them to help them register, that just takes a lot of time and effort. If the

requirement is going to be that we just have the beneficial ownership, I don't know why we just can't keep completing the form and forget about the rest.

But that might not be in the rules. But I just see this as taking more time for us to service our customer. They don't understand, and we can go through all the education, and public service. But our business customers that come into open accounts, they don't have a clue about any of this, and it would be just much easier for us just to fill out the form.

Because the criminals are going to lie on the form anyway, there's no way to verify that anything that they're telling us is the truth, let's just fill out the form.

MEMBER DEVAUX: I'm in the other camp, I'm sorry, Troy. By the way, he's from Delhi, where I used to hang around. If you don't know where that's out, it's about 11 miles south of Epps on Highway 17. But anyway, just joking a

little bit, but I'm in the other camp. I testified before Congress in 2017 or '18 on BSA, and this is one of the things I brought up.

Because if you're working in Miami like I am, sometimes they have eight levels, and multiple branches in this company, and it is a pain, and then you have a customer who goes to four different banks, all four banks do the same process. And it didn't make sense, I'm looking forward to a day when I can push a button, print a form on the customer, give it to the customer to sign, and I'm done.

MEMBER RICHARDS: Well, if it works that way, great.

MEMBER DEVAUX: I know, I know, I hear you.

MEMBER RICHARDS: Reality is not that way.

MS. ARQUETTE: So, this is definitely in the nascent stage, but I think one of the objectives is, I know one of the objectives is to

have a registry, a database with this information, which doesn't exist right now, it's very fragmented, it is bank by bank. You collect information, another bank collects information, hopefully it's the same information if it's the same individual.

But this database will be a repository that can be useful to security agencies, law enforcement just from a national security perspective, and also from a criminal investigative perspective, that's an objective of centralizing the information.

MEMBER RICHARDS: I think we're just going to need to know exactly what our responsibilities are when the customer comes in, and that hasn't been written yet.

MS. ARQUETTE: That's right. So, FinCEN does consult with us on this rulemaking, it will be important to us as well, so that not only you know primarily, and first, but so that we know when we interact with you, and examine

for compliance. Again, verifying the identity of the beneficial owner is still going to be a requirement, that won't change.

So, understanding precisely what the requirements are going to be as the customer due diligence rule is amended will be important to you, and it's equally important to us. Thank you for your comments.

MEMBER DRENTLAW: I am worried a little bit about customers knowing too. I have had, I know an email went out from the secretary of state of Minnesota about this to businesses, and everybody thinks it's a scam because we've conditioned our customers to believe everything is a scam.

And so, now they're telling them to go to this website and enter all of their personal information.

MS. ARQUETTE: I understand.

MEMBER DRENTLAW: It really hasn't been covered in the media, and I think a lot of

people do rely, even on local news to bring this up. And although we can tell our customers that getting an email is -- it concerns them, and I understand where they're coming from, so I don't know if there's any outreach you can do with FinCEN to try and get it out there from a news media perspective.

But I fear that people are going to really miss out on the January 1, 2025 deadline.

MS. ARQUETTE: Those are good points, that might be one of the reasons I was invited to speak here today. If I can get the news to you, and you can share that news with your customers, that's really important. But again, maybe doing another media blitz, we'll share that with FinCEN, because you're sharing very valid concerns and comments.

Not only about your banks, but about the customers that you have, and so I appreciate that, and we'll share that.

MEMBER REIGELSBERGER: I think what we

have seen, I'm from northern Missouri, is, it was hard enough to get -- now, we deal with very small businesses. I mean mom and pop, there maybe there might be three or four owners, so we're talking about very small businesses. And when you start talking about the beneficial owners, or the controller of the business, everybody thinks government is out to get them anyway.

So, to have to release that information was a big hurdle for us, but we crossed it, and this hurdle is oh my God, this is the government coming after me, they want to know everything about it, our customers have really frustrated. Now, I think our local accountants and tax preparers, I noticed that they have included that in with their request for information.

So, several of them have known it, they didn't really understand it, because they didn't realize that's what we were doing when we opened new accounts. So, I'm hoping if this --

as I understood, it promoted this several years ago like you mentioned, it would be basically shifted from our bank to gathering this information, to being at the central repository area.

And again, calling it up, printing it out, and yeah, it's still current. So, I'm kind of hoping that's where we ended up, I guess we will see. I know in our area there's been a little bit of proactive as trying to figure out who these people are. And although the customers are still not happy, but you've just got to help them through it.

MS. ARQUETTE: Thank you. Any other questions? Okay, with that, I will turn the presentation over first to Mike Benardo, and then to Lloyd McIntyre. Mike?

MR. BENARDO: Yes, thank you, Lisa, and good afternoon, everybody. I understand there were some questions and comments this morning maybe before the lunch break about some

fraud issues, and we're happy to address those at the end of this presentation as well. But I think some of the same underlying themes might carry over from the questions you had, because I believe they related to sort of unauthorized, or authorized fraud payments, and such.

So, but first let's talk about check fraud, because I have a pretty good feeling that's a large issue for you guys as well, based on my conversations with many of you at the reception, and at lunch. So, I'm going to turn it over to Lloyd first to talk about that.

MR. MCINTYRE: Thanks for having me today, and we're going to talk a little bit about what's going on in the check fraud space, and what we see in there. The first slide you see here shows data from the Financial Crimes Enforcement Network, and the rapid increase that we've seen in check fraud, particularly over the last two years.

About 97,000 reported incidents in

2014, you can see that number went well over half a million reported incidents in 2022, and has continued to increase in 2023. Next slide. We really started to hear about this from the banking community last year, in 2023. A lot of concern from banks about the overwhelming number of check fraud instances.

We know that this is the second most common suspicious activity type among FDIC-supervised institutions, so it falls right behind the very large category of money laundering and structuring, which covers a lot of potentially illicit activities. But we've been looking at this issue at a little bit more grass roots level really to understand what are banks doing to fight this, what can we do, and what are the consumers doing in the space. So, let's look at a little bit some statistics about check fraud usage, this comes from the Federal Reserve payments system. The Federal Reserve processes about 40 percent of the checks in the country.

And the remaining 60 percent are processed by Fiserv, Jack Henry, and other entities like that. So, you can see that the average daily volume of checks has dropped from about 24 million checks per day in 2013 to a little under 13 million checks per day in 2023. However, business-to-business payments, still about 81 percent of companies in the country still issue checks.

But on the flip side, the average value of those checks has continued to increase. So, that makes this a very attractive place for fraudsters to be. We still issue checks for insurance claim payouts, taxes remitted to the IRS, rent and lease payments, contract payments. So, there's still, even though we may not think about it, the average person thinks I don't write very many checks.

There still are a lot of checks being processed and issued in the United States. So, the common types of check fraud. Mail theft has

become the very serious issue, where fraudsters are simply breaking into mailboxes. They acquire arrow keys on the dark web, they assault postal mail carriers, and they steal checks, and steal mail out of postal facilities.

I'll point you to FinCEN did issue an alert in February of 2023 about the nationwide surge in mail theft-related check fraud schemes, and they ask that banks report that as a special reporting item, if you're aware of a mail fraud-related check fraud scheme. Counterfeiting is still a problem, where fraudsters simply take the information from a real account where they've stolen somebody's personally identifiable information, and they create a check template.

We also see double presentment as a problem, where they can use a drop account to make a mobile payment, and then they go into a check cashing business, and they also cash that check. There's a number of other check fraud schemes that have been out there for decades, but

these are the ones that we really see most common.

Once they acquire that check, and they can acquire hundreds of these checks at a time, they either do them themselves, or they buy them off the dark web, they go through a process of washing those checks, where they can use sophisticated copiers or scanners to create these fake checks. Next slide. And this is what one of those checks looks like after it's been washed through an acid process.

The National Check Fraud Center says there has been around $815 million lost each year to check washing. The U.S. Postal Inspection Service recovers about a billion dollars in counterfeit checks and money orders every year. So, we've been doing research, talking to our examiners, talking to trade associations, talking to experts in the field trying to understand this, again, at the grass roots level.

The rest of your slide presentation really has 13 different governance, technology,

administrative solutions that we've seen that many banks are using. It's different for every bank because the check fraud in your area may be different, it can be geographic, it depends on whether you're maybe dealing with individual check fraudsters, or you may be dealing with organized crime rings in your area that are specifically targeting checks as part of their scheme topology.

I did want to highlight just a few things that we've been working on over the last year and a half. The FDIC Consumer News has published two different publications on check fraud and check washing. One of them was part of an elder exploitation publication that we made in December of last year.

We did open a shared mailbox, we know banks have expressed some frustration about getting that fraudulently altered check resolved by the presenting bank. And so, we did open a mailbox, and we try to facilitate that

conversation between the banks, so that you can try to get the recovery on that.

So, each of the federal agencies have opened those mail boxes, and we're responding to questions from bankers, and helping with that process. We have an interagency fraud working group that we work with, which covers all the law enforcement agencies, the U.S. Postal Inspection Service, so we're having regular conversations with the different agencies that are trying to fight this issue.

As I said, we've done a lot of outreach. I'm here today because we were invited to talk about this. We're talking to trade groups, we're talking to our examiners, we have some additional examiner outreach planned for this summer. So, to really help a lot of people, when I mention check fraud, a lot of people say I don't understand, why are people writing checks?

So, we're trying to get that message

out to people who are not tied to this issue as closely as we are. Do we have any questions? Yes, sir.

MEMBER DEVAUX: It's been frustrating, and one of the areas of fraud, the washed checks, there really is no system to pick that up. It's not positive pay unless they're putting in the payee, and most of the accounts that these are being deposited are at the large banks, they won't talk to us at all.

They won't give us any information, it's a drop in the bucket for them, and we could be out $25,000, they won't talk to us. So, maybe privacy and things like that come into play, but it seems like if we're going to solve the fraud problem, we've got to have more cooperation.

Maybe the mailboxes might be helpful, somebody, intermediary going to the two parties and trying to work it out. But I don't know how they're opening accounts at these banks, because we have to know our customers, and we've lost

money on some really -- it didn't look like the washed check up there. These are professional washed checks, and you can't look at them and tell.

MR. MCINTYRE: And we know that front-end protection is critical, and the detection process, one of the reasons we opened the mailbox was to help facilitate those communications. I think it's important for people to understand that these crime rings are very sophisticated, they're very agile.

In some cases they will open up that drop account, and they will operate it, they will buy gum, they will go to the grocery store, they will operate it as if it's a normal account for months, and then they drop that fraudulent check in there. So, it is very difficult to detect on that end as well, but as Lisa said, everybody is responsible for having a customer identification program, and making sure that you understand that.

We've seen some banks that are investing in more technology in the space, behavioral-based detection processes, automated check validation, where they can use AI and machine learning to detect discrepancies, and anomalous characteristics in a check, but not everybody wants to invest in that, or can invest in that due to cost, and whether your vendor offers it.

So, all these solutions we listed in here, it's going to be different things for different banks, not everything is going to fit your particular circumstance.

MEMBER BROWN: I was also going to comment, $185 million institution in Iowa, and I would love more than anything to invest in a lot of those technology, those fraud protections, but I can't. What we have to pay to core, and all those things, we have so many things coming across in images, it would require a forensics expert to look at images.

I mean, we have staff, we've reduced our mobile deposit velocity limits so that we've got people looking at mobile deposits more closely. Yeah, to be honest, I mean this would be great. If they looked like this, we could find it, that's not a problem. They're better than that.

I mean, but another frustration, and I know this isn't the Treasury, nor is it any of our state government agencies, but why on earth, what happened to we're not going to issue government paper checks anymore? We're having all kinds of fraud with it's a tax refund check, or it's a -- most of our, we've talked to our state banking association, we won't cash them even for our customers.

We'll only accept them for deposit, because we want them to run through an account, Because we don't -- I mean and we're using the Treasury verification, I know that's not a requirement, we recommend it. But then they say

you can use that, we're not sure it's going to work, it might. But we're -- I mean we're trying, we really are.

But in a small institution, unfortunately, some of those, those are just really costly, and so I can't afford to put someone in my back room who is just going to look at checks. And again, they'd have to be a forensics expert.

MEMBER RICHARDS: There's some comments I would like to make on this issue, if you all would just indulge me just for a few minutes. It looks like I'm reading from my notes, it's because I am, I didn't want to miss any points. But I appreciate you putting this on the agenda today, I know Lisa put it on the agenda.

It might have already been on there, but I asked for her to put it on there, so I appreciate it. Thank you to Lloyd for your time today. Lloyd has been working with ICBA’s check fraud task force that I recently got put on, and

he spoke to our group a couple of weeks ago, very helpful, I think for him, and I know it was for us.

I think we're able to drive home the point that community banks are in triage mode with this issue. We are being hit every day, both small and large amounts, possible credit losses are not what keeps me up at night, we can often work through those issues. What keeps me up at night is check fraud.

Bogus checks are coming in our clearings, and posting to our customers' accounts. It might be several days or a month before a customer notices that hey, I've got a fraudulent item posting to my account. By then it's too late, and we're stuck sending a warranty claim to the large banks that are the culprits of this, and those claims are most often denied.

And there are a couple of points I want to make. First, check fraud is happening at the same time that other types of frauds are

happening. ACH fraud, wire fraud, debit card fraud, credit card fraud. But what's especially frustrating about the current level of check fraud is that the losses that community banks are incurring are due in very large part to the absence of sensible deposit standards on the part of the largest banks in our industry.

Yes, the fraudsters are the ones printing up the counterfeit checks, but it's the large banks that are facilitating the fraud due to their lack of any reasonable control. There are obviously no meaningful controls when it comes to their CIP procedures that we just talked about earlier.

They're opening accounts for anybody, anywhere, often through some of these Fintech relationships, and that's where some of the problems are coming in. They don't know who they're banking, they obviously don't have any control over what's being deposited into their banks by mobile deposit, which is the primary

means that the fraudsters are using.

They know what the big banks are doing, and not doing, and they know they have no controls, or standards in place that we can detect for mobile deposit. I'd say at least 90 percent or more of community bank check losses could be avoided if the large banks would just do what's right.

I know FDIC doesn't regulate those banks specifically, that would probably be the OCC. But FDIC does insure their deposits and ours. Regarding CAMELS ratings, this should be a hit on the M in their rating, because it's certainly affecting the E in ours. FDIC sent out an FIL about the CIP process.

I almost laughed, because I thought we're doing this, why are you all reminding us about this? It's not unimportant, it's very important. But I laugh because community banks, I don't think are the main culprits here, it's the big banks. They're the ones entering in bogus

checks into the payment system.

They're crossing their fingers hoping to get past the midnight return deadline. If they can do that, they're scot free. They don't have to pay on our warranty claim unless funds are available in the depositor's account. I've wondered if there could be some sort of class-action lawsuit that community banks could bring against some of these systemically important banks for their failure to exercise ordinary due care and follow best practices.

This brings me to my first point of advice, that's what we're here to do, we're an advisory council. I'd love for FDIC to help us on a few things. We need to work with the Fed on changing Reg CC to extend the return deadline for altered and counterfeit checks to at least 30 days, if not 60.

By shifting some of the liability back to a bank of first deposit, maybe they'll be a little bit more proactive in preventing the

activity in the first place. I know ICBA was keen on that idea, but having FDIC would also be a big help. Another banker reminded me that in shifting the liability, our bank could be finding itself on the other side of that transaction, we could be the bank of first deposit, having something returned to us within 30 days.

My response to that was good, we ought to be held responsible if we're banking somebody that's depositing bogus checks. We should know who we're banking, just like the big guys do. Second, the regulatory agencies need to get involved in how the big banks are responding to our requests for payment.

In most cases we are totally ignored, or routed around in hopes that the level of frustration that results, which is pretty high, will just leave us simply giving up. Lloyd had mentioned that one of his suggestions was that the exam teams need to be aware of what the problems are that are resulting in check fraud,

such as inadequate CIP.

But they also need to be looking at how these banks are responding when fraud does occur, and the timeliness of the responses. I had a $10,000 check fraud loss on a local church account, and it took over three months to get it resolved, that's not acceptable. And third, community banks are having to go through the process of trying to figure out how to protect ourselves.

Not only against the fraudsters, but also the large banks who are facilitating those losses. And yeah, that's what I'm saying, they're facilitating those losses. We're in the process of purchasing and installing software that uses historical check image data to compare incoming checks to.

It's not foolproof, and it's not cheap, but it is reasonable, and I've got information on the company that we're using if anybody is interested. But why should I have to

invest in technology to avoid those losses, which affects again, our E in our CAMELS ratings, when the big banks don't?

They're not held to the same standard. At the same time all of this is going on, there is a constant assault on our ability to earn non-interest income through fees and charges, yes, like OD and NSF charges, which would help to offset both the losses, and the added cost of the additional safety measures.

It would be a wise thing, we talked about sending out questionnaires to banks, I think it would be a wise thing if FDIC would send out a questionnaire to banks asking about the volumes of their losses in this area, and the added expense of properly defending themselves. A lot of information is gleaned from SAR data.

But we don't fill out SARs on every one of these, because when the suspect is unknown, unless it's $25,000, we don't fill out a SAR. There's a lot of under reported, the

numbers you have are way under reported. Year to date we've lost about $30,000, and that's big for us.

But not as big as a bank in Baton Rouge that called me about a $450,000 check fraud loss that they suffered due to a counterfeit check being mobile deposited, a $450,000 check mobile deposited, I'm not going to say the name of the bank. No limits, no safeguards, they eventually got it resolved, again, after months and months of frustration.

So my advice, and I promise this is the end, my advice, or my ask of FDIC, one, help us get some relief by working with us to try to get the Fed to change Reg CC to extend those return deadlines. Two, immediately put pressure on the larger banks through their regulators to strengthen both their account opening procedures, and their mobile deposit standards.

And three, let us continue to earn fee income to help offset those losses, and offset

some of the additional expense being incurred. And I thank you for listening to me.

MR. MCINTYRE: Thank you, Troy.

MEMBER REIGELSBERGER: I think we should give him a round of applause, just exactly right.

MEMBER MAUST: I was thinking about, for a different reason, that return window is an interesting one. Because we've seen the opposite also happening on the other side of the equation, which is we have been the bank of first deposit for various merchants who had received for payment of goods and services, a check that was returned.

So, these are consumers, a check that was returned from a G-SIB, and multiple ones, for potential fraud. It was not, but having to go through the process, I kind of wonder about the consumer harm that's resulting because of the requirement to determine whether there's representment and dealing with the merchant

versus customer or consumer.

And so, widening that return window would address both sides of the equation, that's interesting. I don't know if that's really been brought up before, if we're the only ones who have experienced that as a bank of first deposit. But in addition to the fraud, I do worry about the consumer harm.

That as the anti-fraud efforts are ramping up at larger institutions, they're just kicking it back. And there are knock on effects that occur on the consumer side as well.

MEMBER DEVAUX: So, just one last quick comment. Our local FBI has asked us to report every one to them, because there's so many check fraud rings out there, and we had a customer where we actually -- we look at the check, and if it's over a certain amount, we call the customer. The customer was on vacation in Europe, we told them the amount of the check.

Yeah, that's the correct amount, it's

made out to so and so. He goes well, it's to my attorney, I don't really remember their name, but go ahead and pay it. So, he got back two weeks later, the FBI contacted him, and said by the way, we found some of your checks, and this person we arrested has some of your checks, and sure enough it was a fraudulent check.

But we had him on recording that he said pay the check, I don't know who it was made out to, but the amount is right, everything is right on there, it was just a washed check. So, they want to see the information, so maybe if you have a good relationship with your local FBI, you can report these, and they might put them together and break some of the rings.

MR. MCINTYRE: Yeah, one of the banks that I spoke to over the last year talked about a nomadic, they described it as a nomadic check fraud ring that would go from state to state. And they would break into mailboxes, and then you would see check fraud pop up a little bit later

after that.

And they talked about the relationship they built with their local law enforcement, and again, local law enforcement has a lot of other things going on, so check fraud may not be top of the mind, but that's one thing I talk to bankers about. Is talking to your local sheriff's department. Tell them this is something that's happening.

So, that if they know about a mailbox that's been broken into, they might expect that in the next 30 to 60 days your bank, and other banks in your area might be seeing a jump in check fraud. So, building that relationship ahead of time, and explaining to them what it looks for might enable them to be able to crack some of these rings very early on in the process.

MEMBER REIGELSBERGER: It seems like at our bank we've had a little bit of the check fraud issue, most of it has got to do with all the other fraud that you mentioned. Whether it

be ACH, whether it be as I mentioned this morning, the cash Apps, whether it be Facebook, fraudulent sites that people go and buy stuff on.

Between all of the above, the mail fraud, the ACH, the scams, the customers participating in the scams, our losses just year to date is almost $20,000, now we're only a $145 million bank, I can't take that. I mean, at what point do you throttle in all your debit card requirements, or your account requirements to where the window is so narrow that your customers are frustrated?

But you can't absorb these kind of losses. If I'm going at this point, I've still got this much more of 2024 to go to. I mean, I don't know what we're going to do with all this. I can't afford to have all this, we don't have an answer yet, we're going to be talking about it when I get back next week. But there is just way too much fraud, and I just don't know what to do about it. Don’t know what to do about it.

MR. BENARDO: Yeah, and I think this relates to the question that was maybe asked this morning before lunch, that what's at the root of so much of this is social engineering, that’s really what it's all about is the bad guy tricking a person into giving up money or information, which is just as valuable as money these days.

And so it's the romance scams, it's the I'm selling something on Facebook and it's not really worth what I claim it to be. But convincing the person to send money for whatever reason, and it's become a big issue. We've been hearing a lot about too is what has been referred to a lot as push payment fraud, or authorized fraud versus unauthorized fraud.

Because Regulation E, the Electronic Funds Transfer Act, covers a loss if a person - an unauthorized access is made from a customer's account. If someone compromises their login ID and password, and then uses it to make a fraudulent payment, or somehow gets a virus on

their computer and accesses their online banking, and then makes a payment.

So, those are covered. But when it's a fraudster convincing somebody overseas or whatever to send them money, and the customer is the one pushing the send button, that is not covered by Reg E, that's not an unauthorized access. So, we were having a robust conversation at lunch about where do you draw the line these days?

Because if someone is pressuring a person into making a payment, is that really authorized? Especially maybe if they're threatening them with violence, or if they have convinced them to believe something that they would not have otherwise authorized a payment for, but now they are. So, the law doesn't consider those sort of gray areas, and so it's something that we definitely need to figure out.

We're talking with our colleagues at the Fed, and others about it, but I just don't

know how the regulation can fix this type of fraud.

MEMBER RICHARDS: Your colleague at the OCC, we mentioned this this morning, was recently recorded comments that he feels like when it's authorized fraud, I guess for lack of a better term, that we should still pay. The bank that the money came from, and the bank that the money goes to should split the customer's fraud loss 50-50. And again, that's just insanity. I can see where that would be gamed all day long if that were the case.

MEMBER DEVAUX: We should split it by the percentage of assets.

(Laughter)

MEMBER DRENTLAW: I think I mentioned this at lunch too, that could go further. We have an attorney general that came to one of our bankers in Minnesota, and one of their customers had been scammed by a contractor. They gave a down payment, the contractor didn't do the work,

and the attorney general wanted the bank to reimburse the customer.

And so, if we go down this road of splitting every loss with all consumers, there is no personal responsibility anymore to do your homework about anything, because we just have to eat it. And I mean I think the attorney general is not going to have a case against this bank, but I worry that that might be the direction that it starts to go if we have this stuff continue with no safeguards for us.

And we're a small business, I mean I'm fourth generation at a $185 million bank, this is our family's asset that has been around for 120 years. I don't look at myself any different than a plumber, or an electrician, or somebody that owns a grocery store, I just happen to be a bank.

And I don't know where that goes then for community banks. Because there's nowhere to absorb that loss. We're not independently wealthy, that can just keep putting capital in to

absorb these kinds of losses.

MEMBER REIGELSBERGER: I think that personal accountability for our customers is so important, because we have had numerous scams where our customer was what I want to call the money mule, maybe. They thought they were going to get a kickback on the monies that were part of this fraud, and when you talk to them about it, yeah, if it worked I was going to make $500.

If this worked I was going to make it. Because the bad guys were telling them well, the bank is going to cover most of it. You won't be out of anything, and we'll do one after another. So, that accountability on their part, if there's no ramifications, obviously we're going to close that account. I don't want them, they can move on down the road to somebody else.

But that fear of what you just mentioned about that accountability, I don't know, it's just really, really frustrating as a banker.

MR. BENARDO: And just one more comment on that, I think some of us were talking about this at lunch too. That I think as an industry we kind of have a little bit of ourselves to blame as far as how the credit card industry has gotten so good at detecting fraud, and there is what is perceived to be zero liability, and a lot of them just come right out and make that claim.

And so, I've heard of consumers buying something for example on Facebook, and if it's not really what I thought it was, then I'll dispute the transaction, or if I don't like the color, I'll dispute the transaction, or whatever. And there's this perception that that should now transfer to all these other sort of payment types too, and it's much harder to do on the back end than sort of the way the credit card companies handle this.

MEMBER RICHARDS: As a bank of first deposit, we have as many safeguards in place as

we can. I incentivize my tellers, if they catch a bogus check that somebody got in the mail, we pay them a $25 bonus. And boy, they analyze it to death when it comes in. But we have caught so many bogus, counterfeit checks on our mobile deposit. We have a $2500 daily limit for mobile deposit.

We look at every mobile deposit to make sure that it's endorsed properly on the back. We're doing, as a bank of first deposit, everything we can do. Now, will we catch everything? No. But it just seems like it's an uneven playing field, and the larger banks don't have any safeguards, and controls. And that's why the criminals are going there. Because then we get to pay for it.

MEMBER BATES: Yeah, good discussion. We're seeing the same thing, and I think probably everybody in the room, if you mention one or two larger institutions particularly, those are the ones that we have to deal with mostly, by and

large. And it has been real, we've recently had to basically revamp our operations, and create a separate fraud division just to work on that.

I surveyed our fraud incidents last year, and then our first quarter this year. And our first quarter volume is half of last year's total volume. Now, that's not losses, that's just fraud instances we have to work, there are some losses with that. So, I think it's going to take a concerted effort amongst us and the regulators.

Because the one thing that I tell people, they ask me about my job, and I say it's a new adventure every day, but there's only one thing that is constant. Every day somebody is trying to steal money from us. And many times the regulations have good meaning, but our consumers will actually use it against us.

We see numerous instances where they're not all benevolent. They use loopholes in the regulation to get money from us without

having to pay it back.

MR. BERARDO: Thank you.

MS. PEARSON: I want to thank you all for the robust discussion, and sharing your perspectives. I particularly want to acknowledge you sharing your concerns, and providing very specific feedback. I also think it’s important to make sure that when we’re having these conversations, there are opportunities to make the invisible visible when we’re having these conversations.

So that there’s also situations when there are individuals who are victims in these situations, that when they experience loss, those losses for them could mean they don’t eat, or they don’t have medicine, or they don’t get a chance to pay their rent, and it’s not a profit or a loss for those individuals.

And so, yesterday when we were at the MDI subcommittee, one of the things we talked about is sometimes the victims can be elderly

people, and the very people who are scamming them over and over are the exact individuals who are responsible for taking care of them. So, as we're having these discussions, one of the rules that I like to have is that we make sure that we have a conversation that includes making the invisible people in those conversations visible.

And so, that's the role that I would like to play in this conversation today, so I thank you for indulging me in that. Thank you all panelists. In our final segment for today we would like to discuss the final rule for FDIC official signs, advertising statements, false advertisements, misrepresentations of insured status, and misuse of FDIC's name or logo.

I keep trying to name this segment signs of the times, but nobody has taken me up on this. You took me up, okay good. Luke Brown, who is associate director of the Supervisory Policy Branch in the Division of Depositor and Consumer Protection is going to moderate this

discussion.

Joining him for the discussion is Meron Wondwosen, assistant director of the Supervisory Policy Section. Edward Hof, senior policy analyst both from the Division of Depositor and Consumer Protection. And Chantal Hernandez, counsel from the Legal Division. Luke, I'll turn it over to you.

MR. BROWN: Great. Good afternoon everybody, it's good to be here. Very interesting conversations, I think some of the things that we're about to touch upon related to fraud, and other unfortunate things are going out there in the market that we're trying to address through this rulemaking, so we look forward to the conversation.

So, our presentation today focuses on a regulation that the FDIC issued at the end of last year related to the FDIC's primary mission of promoting and maintaining public confidence in the banking system, and of course in FDIC deposit

insurance. As you know, increasingly consumers are presented with an array of financial products and services offered online through banks, but as well through non-bank entities.

As consumers have increased their reliance on internet and mobile channels to access banking and financial services, consumers may not fully understand if they are interacting with a bank, and whether funds are protected by FDIC deposit insurance. In addition, the FDIC has seen misrepresentations online by persons including non-bank entities regarding deposit insurance coverage in numerous forms.

These types of misrepresentations can cause confusion and create uncertainty, which can erode consumers' confidence in banks, and in the protections afforded by the FDIC. To address these concerns, in December of 2023 the FDIC board approved amendments to Part 328 of the FDIC's regulations. As Nikita said, it's a long name for this rule, governing bank's use of the

official FDIC sign in advertising statements as well as rules related to false advertising and misrepresentations regarding deposit insurance, and misuse of the FDIC's name and logo. First, the final rule modernizes the FDIC sign and advertising rules. But for most community banks with traditional bank branch footprints, the final rule would not significantly affect a community bank, not much has really changed in terms of the rules.

We'll talk more about that, much of the focus is related to online, to sort of fill some gaps there, and modernize the rule. The second piece of it clarifies the FDIC's false advertising and misrepresentation prohibitions. Again, related primarily to non-bank entities that are using FDIC symbols, and logos, and information to imply online that there is FDIC insurance when there is not.

So, the rule aims to help consumers clearly understand when they are dealing with a

bank, and when their funds are protected by the FDIC's deposit insurance. In the fall of 2023 the FDIC launched its know your risk, protect your money public awareness campaign, which underscores how important it is for consumers to understand how deposit insurance works, and how it protects their money.

You might have seen online advertisements from the campaign featuring Penny the Pig. The FDIC sign and misrepresentation rule complements that work, and by the way, if you haven't met Penny the Pig, or you're not familiar with her, she's on my lapel sitting here watching us right now.

With that, I will now pass the baton to my colleagues. Our panel today will describe some background information, the primary provisions contained in the rule, focus on misrepresentations, and the FDIC's efforts to implement the final rule. After we conclude our formal remarks, we're happy to engage in a

conversation and answer your questions. So, with that, Meron, it's all yours.

MS. WONDWOSEN: Thank you. Good afternoon everyone. As Luke mentioned, the final rule supports the FDIC's mission. The FDIC has promoted public confidence and stability in our nation's banks and their customers through several crises, including the 2008 financial crisis, and the COVID-19 pandemic, and most recently when large regional banks failed in the first half of 2023.

Since the 1930s, the gold and black FDIC official sign has been displayed next to bank branch teller windows to give bank customers confidence that they're dealing with an FDIC-insured bank, and that their deposits are safe. Next slide please. Part 328 was last updated in 2006, and since that time, as you all know, there has been significant market and technology developments, and consumer-banking habits have substantially changed.

I'll mention a few of the developments from the slide. First, bank customers increasingly rely on internet and mobile banking channels to access banking products and services. Many consumers use their bank's websites or mobile banking apps as their primary method of accessing banking products.

These platforms essentially serve as a bank's digital teller windows for these bank customers. Through these platforms, consumers can now access deposits, as well as non-deposit products. Examples of non-deposit products include insurance products, annuities, mutual funds, securities, and crypto assets.

These developments can serve to blur the distinction between banks and non-banks, as well as between deposit and non-deposit products, potentially creating confusion for some customers. At the same time, the FDIC has observed an increase in misleading representations about deposit insurance from

persons including non-bank entities.

Such misleading statements can create uncertainty, and could dilute and undermine the public confidence that underpins our banks, and our nation's financial system. Through the final rule adopted by the FDIC board in December, the FDIC sought to address these developments and misrepresentations about deposit insurance. Next slide please.

The rule has two parts. Subpart A of the regulation governs the FDIC official signs, including the newly established digital sign, as well as the use of the advertising statement. Subpart A applies to all insured depository institutions. Subpart B governs misrepresentations, and applies to any person, including banks as well as non-banks, and prohibits any person from misusing the name or logo of the FDIC, or from engaging in false advertising, or making misrepresentations about deposit insurance. The rule became effective on

April 1, 2024, and has a compliance date of January 1, 2025. Next slide please. This rulemaking has the following objectives.

First, the final rule modernizes the FDIC official sign and advertising rules to ensure they keep pace with significant changes that have taken place in the banking industry, and that they reflect how consumers engage banks today.

Second, the final rule clarifies the FDIC's false advertising and misrepresentation prohibitions to address misconduct in internet banking channels by persons including non-bank entities that are misusing the FDIC's name or logo, and inaccurately describing FDIC deposit insurance coverage.

Third, the final rule as a whole helps to ensure consumers to better understand when they're dealing with a bank, and when their funds are protected by the FDIC's deposit insurance coverage. Next slide please. The final rule

amended the requirements for the display of the official FDIC sign in physical bank premises.

For most banks, as Luke was mentioning, not much changes. If a bank has teller windows the official sign must be displayed at each teller window or station. This is not a new requirement, it maintains the status quo. The final rule also provides some options for banks.

For example, under the final rule, if a bank does not offer non-deposit products, the bank has the option to replace the teller window base signs with one or more official signs visible from the deposit taking area. Second, there are some newer bank locations or layouts such as café style banks that do not have any teller windows or stations, and where deposits may be received in various areas throughout the location.

In such locations under the final rule banks must display the official FDIC sign in one

or more locations in a size large enough to be legible from anywhere in those areas where deposits are usually and normally received. Next slide please. Now, we'll move from the official sign in banks' physical premises to the digital banking channels and the new FDIC digital sign, which you see here on the slide.

The final rule established and requires the display of a new FDIC official digital sign on bank digital deposit taking channels such as websites, mobile applications, as well as certain bank ATMs, and other like devices after January 1, 2025.

Specifically, banks must clearly, continuously, and conspicuously display the new FDIC official digital sign on bank websites, and mobile applications in close proximity to the bank's name near the top of the page or screen on the home page, landing or login page, and pages where customers may transact with deposits.

Over time as consumers get used to

seeing the new digital official sign on bank websites, we believe it will register for consumers that this is a signal to them that they're interacting directly with an FDIC-insured institution, and that their deposits are safe. Next slide please.

The final rule also establishes requirements for an insured bank to display non-deposit signs when it offers both deposits and non-deposit products. Generally, a bank must display a non-deposit sign indicating the non-deposit products are not FDIC insured, are not deposits, and may lose value.

This particular requirement is intended to be generally consistent with the practices described in the long-standing interagency guidance on the retail sale of non-deposit investment products. In addition to the requirement that a non-deposit sign be displayed clearly, continuously, and conspicuously in a physical bank branch.

The final rule also requires the display of the sign when deposits and non-deposit products are offered in digital banking channels, including websites, and mobile apps, and certain bank ATMs. Under the final rule, the non-deposit sign must be displayed clearly, continuously, and conspicuously on a bank's digital banking channel pages related to non-deposit products indicating that such products are not deposits, are not FDIC insured, and may lose value. I'll now turn it over to my colleague, Ed.

MR. HOF: Thanks, Meron. As mentioned at the outset of the presentation, one of the main objectives of the final rule is to address the increased instances of deposit insurance misrepresentations by persons such as non-bank entities that can cause consumer harm. Such misrepresentations, if left unaddressed, can confuse consumers as to whether they're interacting directly with an FDIC-insured bank, or a non-bank entity and whether they're dealing

with an insured deposit product, or a non-deposit product. The final rule aims to address these situations by clarifying the misrepresentation prohibitions, and providing some specific but non-exhaustive examples.

Subpart B of Part 328, which applies to any persons, including banks and non-bank entities, provides further clarity on the application of the misrepresentations in the statute in specific situations where consumers may misunderstand or be misled as to whether an entity is insured by the FDIC, whether a particular financial product is FDIC insured, or the nature and extent of deposit insurance coverage.

Next slide please. In the final rule, Subpart B of Part 328 includes examples of specific statements and material omissions that constitute a misrepresentation, which will be helpful in providing more clarity about the final rule. As we mentioned in the previous slides,

these examples are a non-exhaustive list of conduct that may violate Part 328.

I'm not going to go through all the examples on the slides, but we'll walk through a couple just for discussion purposes. First, a non-bank's use of any FDIC-associated terms or FDIC-associated images constitutes a misrepresentation of insured status if it inaccurately states or implies that a non-bank is FDIC insured.

Second, if a non-bank makes statements regarding deposit insurance to its customers, it is a material omission for the non-bank to fail to clearly and conspicuously disclose that it itself is not an FDIC-insured institution, and that the FDIC's deposit insurance coverage only protects against a failure of an FDIC-insured bank.

Next slide please. In addition, if a person makes statements regarding deposit insurance in a context where both deposits and

non-deposit products are offered on a website in close proximity, it is a material omission to fail to disclose that non-deposit products are not insured by the FDIC, are not deposits, and may lose value, subject to certain limited exceptions.

Another example involves representations or statements about pass-through insurance. If a person makes statements regarding pass-through deposit insurance for its customer's funds, it is a material omission to fail to clearly and conspicuously disclose that certain conditions must be satisfied for pass-through deposit insurance coverage to apply.

Next slide please. The final rule also requires banks to establish and maintain written policies and procedures to achieve compliance with Part 328. The policies and procedures must be commensurate with the nature, size, complexity, scope, and potential risk of the deposit taking activities of the insured

institution.

Next slide. Now that the rule is final, the FDIC is currently engaged in implementation activities. For example, the FDIC will host four seminars for bankers and other stakeholders specifically focused on the final rule. During these seminars, FDIC staff will discuss the final rule's requirements, and answer questions we've been receiving from bankers.

Second, since the rule was issued we have been receiving and responding to questions from bankers and other industry stakeholders. Third, the FDIC is leading the effort to develop and coordinate on an interagency basis, the development of interagency exam procedures addressing the final rule's requirements.

And with that, I'd like to thank you all for the opportunity to present on the final rule, and we look forward to your questions.

MEMBER PLUMSTEAD: Has the FDIC been in contact with any of the core providers who

provide our online banking apps if the expectation is that the logo will be somewhere embedded within the app? Does anyone know if they're aware of this new guidance?

MR. BROWN: Yes, thank you for that question, it's a good question. We have met with a couple of core providers, and have had extremely productive conversations as they've walked through, sort of as they're trying to implement it for hundreds of banks, and we've shared observations based on what they've described.

One thing that's been helpful for us is we have -- the effective date is January 1, 2025, of course. We did not get as much feedback as we would have liked to have received, but as we've talked to the cores, it's clear that they have no problem, despite the fact that they're developing materials for hundreds of banks, meeting our compliance date far before the end of the year.

So, that was helpful to know, and quite frankly our dialogue continues with the cores, so the answer is yes. But we also heard from large banks, small banks, and other types of vendors. It's been a helpful back and forth.

MEMBER PLUMSTEAD: Thank you.

MR. BROWN: Sure.

MEMBER JAMES: My question is actually similar, and I want to dig deeper into your communication with the core providers. I looked on my mobile app to see where the FDIC logo appears, and it didn't appear until I clicked on mobile deposit. And I haven't read the rule yet, but it sounds like that's going to have to get changed.

MR. BROWN: Correct.

MEMBER JAMES: My other comment is more of, I think your digital logo needs some sprucing up, because it looks pretty -- it looks like a pretty bland font. I mean the old gold sticker I think is a better looking, you know, I

looked on our mobile app, it has a facsimile of the gold sticker, which I think is a better looking logo. So, I would advise --

MR. BROWN: Well, we are a bank regulator, so that's --

MEMBER JAMES: But you guys, you know we're paying a lot of premiums, you can get a graphic designer to --

MR. BROWN: Appreciate the commentary.

CHAIRMAN GRUENBERG: Robert, thank you for the design consultation.

MR. BROWN: But I do want to highlight, so this ties again to the conversations earlier, and I understand that you talked about fraud this morning as well. I don't know if you've ever done this, but if you play around on the internet, it's surprising how many financial technology companies have websites where they're appearing to look like a bank.

And on the other side of it there's a lot of banks that have websites where they're

appearing to look like a financial technology company for marketing reasons, I don't know what the reasons are. So, in the future with this new digital sign, we hope that the consumers will be accustomed to seeing at the top of the website, the bank name, ABC Bank.

And immediately below that, or to the right of it, it's got to be in close proximity, FDIC insured, backed by the full faith and credit of the United States Government. So, over time people will click, and they'll absolutely know something is a bank, as opposed to a non-bank entity. So, we look forward to that beginning in January.

MS. PEARSON: Robert's saying if it's going to be next to his bank's name, he wants a prettier sign.

MEMBER JAMES: And more colors, yes.

MEMBER MAUST: Some choice, like a palette of colors to match. Actually I don't know if this would be popular, but I really like

where this is going, because I think there's been a lot of confusion in the market. And so I made some notes, because I want to make sure that we can implement it. And I love the fact that the rest of the industry and those outside the industry also must implement.

Because that conspicuous placement of FDIC, and what I really like actually is that statement backed by the full faith and credit of the U.S. Government, that's very powerful, and that didn't exist before, at least that conspicuously, and so I'm not quite sure how we're going to fit that on our mobile app, because that's a lot to write in there.

We can make it really tiny, but it's got to be conspicuous. But yeah, I just want to at least say that.

MR. BROWN: Well, thank you for the comment. And quite frankly, that language comes directly from the statute, from the FDI Act, and so that's why that is required to be, but it's a

clear statement about the protection that banks bring ultimately through the FDIC insurance. So, we hope that's positive as well.

MEMBER JAMES: What are the penalties for non-banks who fail to comply?

MR. BROWN: So, others can probably answer the details, but we have broad authority in this space. We can issue cease and desist orders, we can take enforcement actions. With respect to the specific penalties, I don't know if our attorneys can answer that. We can do CMPs, correct?

MS. HERNANDEZ: So, you had asked about specific penalties for non-banks' use. There is potential criminal prosecution, so that is one. In terms of financial penalties, I don't see it here, but that is the remedy there. And as they stated, enforcement has taken steps to address those misrepresentations through advisory letters, through cease and desist letters. And they will take enforcement action

if necessary to stop that misconduct.

MR. BROWN: Yeah, and our chairman will attest, we've been extremely serious as we've seen these things online, we've been aggressive because we think not only does it harm consumers, of course as we said earlier, it degrades the confidence in the FDIC and what we bring.

So, when we see it, we're going to take action, and the extent that these entities are not real, and there's fraud involved, we have a whole -- Michael Benardo who presented earlier, we work very closely with his offices, and we take down those websites entirely that are fraudulent, and false.

CHAIRMAN GRUENBERG: Yeah, I would add we've had a number of instances, non-bank financial companies making flagrant misrepresentations asserting that they were protected by the FDIC. And it goes to the heart of the credibility of the agency and the deposit

insurance system if a company that is not protected by the FDIC makes false assertions, and can really confuse the public, and create serious disruptive effect.

So, if we identify it, and we do monitor closely, we will send them a letter asking them to -- I should say directing them to cease and desist. And if they don't, as Chantal indicated, they could be subject to a range of enforcement actions. So, it's really a very serious matter that we pay close attention to.

It becomes even more sensitive, some of these non-bank companies have relationships with banks, and some of them have traded on those relationships to try to mislead people as to deposit insurance coverage, and particularly sensitive in those areas. And for any bank that is utilizing a third party, you really do want to be careful as to what misrepresentations your partner company might make.

Normal course, that does not happen,

but there are some bad actors out there that I think we all need to be careful about.

MEMBER HORTON: Is this on? My only other comment, I know this is not the primary concern, but in our area, credit unions are continuing to use the term banking. Come and bank with us, bank with us, bank with us. Where does this lie with NCUA insurance? Is it going to say that it's got the full backing of the federal government?

I mean my understanding is it is different. And can you respond to that?

MR. BROWN: Sure. So, there's a whole separate set of laws that apply to credit unions, separate from what we do. Obviously we're focused on banks, so what we're doing is not -- it doesn't impact. They could follow us, and issue a similar rule I imagine, depending on their authority. I understand your concerns about the question of the word bank, or banking.

That's something we've certainly

discussed as part of this rulemaking. The challenge is that kind of terminology is generally related to state law, and so if someone is using the word bank or banking online, and unfortunately implying that they are a bank, there's not much that the FDIC can do about it because it's driven by state law. So, that's how I would respond to that question.

MEMBER HORTON: Thank you. And I do agree, it's nice to have the full backing of the federal government as part of our logo.

MR. BROWN: Great.

MS. PEARSON: Thank you very much to the panelists. Chairman, I'll turn it over to you for closing remarks.

CHAIRMAN GRUENBERG: Thank you, Nikita. Listen, thank you all, this has really been a terrific conversation today. My experience with community bankers is that you're generally not shy to express your thoughts and views, and it's one of the reasons we invite you

here, if I may say. We benefit enormously from the feedback you provide us, and as usual, it has been both thoughtful and candid.

And so, we're deeply appreciative, really. And if I may, let me also offer a word of thanks to our staff, who have made outstanding presentations today, and I think really facilitated the meaningful engagement on a range of issues. So, very much appreciative. I'd like to thank our very capable moderator, Nikita Pearson for also facilitating the conversation today.

And also thank all the staff that helped set up this event, which has really been so enjoyable, and convenient for all of us. So, with that we invite you back to our next meeting this fall, I think it's going to be in November, and we look forward to seeing you then, and thanks again for your time.

(Whereupon, the above-entitled matter went off the record at 3:02 p.m.)