The Meeting of the Advisory Committee on Community Banking

of the

Federal Deposit Insurance Corporation

Held in the Board Room

Federal Deposit Insurance Corporation Building

Washington, D.C.

Open to Public Observation Via Webcast

July 28, 2020 – 1:00 P.M.

The meeting of the FDIC Advisory Committee on Community Banking ("Committee") was called to order by Jelena McWilliams, Chairman, Federal Deposit Insurance Corporation ("FDIC") Board of Directors.

Committee members present at the meeting were: Shaza Andersen, CEO, Trustar Bank, Great Falls, Virginia; Dick J. Beshear, Chairman, President, and CEO, First Security Bank and Trust Company, Oklahoma City, Oklahoma; Fred DeBiasi, President and COO, Valley Central Bank, Liberty Township, Ohio; James J. Edwards, Jr., CEO, United Bank, Zebulon, Georgia; Keith Epstein, Executive Vice President and CEO, Roxboro Savings Bank, SSB, Roxboro, North Carolina; Sarah Getzlaff, CEO, Security First Bank of North Dakota, New Salem, North Dakota; Kenneth Kelly, Chairman and CEO, First Independence Bank, Detroit, Michigan; Bruce Kimbell, President and CEO, First Community Bank of the Heartland, Clinton, Kentucky; Thomas Leavitt, President and CEO, Northfield Savings Bank, Northfield, Vermont; Lori Maley, President and CEO, Bank of Bird-in-Hand, Bird-in-Hand, Pennsylvania; Teri Messerschmitt, President and CEO, South Ottumwa Savings Bank, Ottumwa, Iowa; Patty Mongold, Chairperson, President and CEO, Mt. McKinley Bank, Fairbanks, Alaska; Gilbert Narvaez, Jr., President and CEO, Falcon International Bank, Laredo, Texas; Mark Pitkin, President and CEO, Sugar River Bank, Newport, New Hampshire; Alan Shettlesworth, President and COO, Main

Bank, Albuquerque, New Mexico; Cathy Stuchlik, Chairwoman and President, Clackamas County Bank, Sandy, Oregon; and Louise Walker, President and CEO, First Northern Bank, Dixon, California. All Committee members attended via videoconference.

Stephen Hayes, Chairman and President, Dakota Prairie Bank, Ft. Pierre, South Dakota, was absent from the meeting.

Director Martin J. Gruenberg attended the meeting, and Corporation staff who also attended the meeting included: Bobby R. Bean, Mary Calkins, Leonard N. Chanin, Kymberly K. Copa, Carolyn D. Curran, Chad R. Davis, Doreen R. Eberley, Bret D. Edwards, Andrea W. Eley, Diane Ellis, E. Marshall Gentry, Jasa J. Gitomer, Shannon N. Greco, Patricia S. Gurneau, Leon Hartley, Travis J. Hill, Frank R. Hughes, John R. Jilovec, Nicholas S. Kazmerski, Arleas Upton Kea, Sandra K. Kerr, Claire N. Lam, Yan Y. Lee, Alexander LePore Jr., M. Anthony Lowe, Christopher Lucas, Ashley M. Mihalik, Brandon Milhorn, Rae-Ann Miller, Patrick Mitchell, Arthur J. Murton, Shayna Olesiuk, Mark E. Pearce, Nicholas J. Podsiadly, John Rieger, Lisa K. Roy, Betty J. Rudolph, Mike Shaheen, and James P. Sheesley. Mr. Gruenberg and all FDIC officers and staff, except for Mr. Davis, Ms. Greco, Mr. Lucas, Mr. Milhorn, Ms. Roy, and Mr. Shaheen attended via videoconference.

Jocelyn Sutton, Deputy to the Director, Consumer Financial Protection Bureau, also attended the meeting.

Chairman Jelena McWilliams opened and presided at the meeting. Chairman McWilliams noted that this was the first Committee meeting with all the Committee members participating via videoconference. She thanked the Committee members and their institutions for the front-line role that they are playing in responding to the COVID-19 pandemic and for their efforts to assist their borrowers with meeting their obligations. Chairman McWilliams welcomed the new Committee members: Shaza Andersen, CEO, Trustar Bank, Great Falls, Virginia; Teri Messerschmitt, President and CEO, South Ottumwa Savings Bank, Ottumwa, Iowa; and Patty Mongold, Chairperson, President and CEO, Mt. McKinley Bank, Fairbanks, Alaska. She then introduced Chad R. Davis, Deputy to the Chairman for External Affairs and the Committee's Designated Federal Officer, who moderated the proceedings.

Mr. Davis introduced the first session, which was a roundtable discussion of local banking conditions. The Committee members discussed a range of issues, including the following:

COVID-19 Operational Response. All members involved in the discussion reported on their operational responses to the COVID-19 pandemic. Each banker reported temporarily closing their institutions' lobbies to customers, with one member still operating with a closed lobby. They described relying on drive-up facilities, online banking services, and office access by appointment only to continue business operations during periods when public health authorities recommended business closures, or when indicated by their own judgment. Most bankers reported widespread use of telework arrangements for staff. Some members said they

had scaled back or postponed elements of their strategic plans in recognition of changed circumstances wrought by the pandemic. Member Shettlesworth described the particular risks that an office-wide outbreak posed to his one-location institution. Committee members reported requiring or encouraging mask use by lobby customers after reopening, but stated that customer use of online and drive-up access remained elevated. Member Edwards stated that his bank's resilience exercises proved valuable in implementing a COVID-19 response, and Member DeBiasi expressed an appreciation for regulator examination of pandemic plans.

Economic Conditions. All members noted the serious effects of COVID-19 on the economic conditions in their communities. Many reported dramatic increases in unemployment and other consequences of the shutdowns ordered in response to the pandemic. They observed that these consequences were most severe in the hospitality industry, especially in those locations with significant tourism. Member Leavitt and Member Narvaez, from institutions located near the northern and southern borders, respectively, related that the closing of borders to non-essential traffic had affected retail and hospitality in those areas. According to several members, the lifting of stay-at-home orders eased some of these difficulties and created a sense of optimism in their local banking communities. Other members expected the effects of the pandemic to be long lasting, requiring a response of similar duration and creating a "wait-and-see" mindset. Many members noted strengths in the residential real estate markets, especially single family, with multifamily rent delinquencies generally being less than expected. Members reported low single-family housing inventories and high asset values in that segment, which – when coupled with the low interest rate environment – resulted in strong single-family mortgage lending for many institutions. Similarly, some members described relative strength in manufacturing and agriculture.

Paycheck Protection Program. Nearly all members reported participation in the SBA Paycheck Protection Program ("PPP"), with some obtaining SBA authorization for the first time to originate the loans. Member Maley stated that her institution engaged a non-bank (Kabbage) to aid in processing PPP loan applications. Members described the PPP loan program as ameliorating the effects of COVID-19 on customers, limiting the amount of distress on assets and the need for modification. They also reported that PPP loans were originated to existing borrowers as well as borrowers with no preexisting relationship with their institutions. Members also described a perceived advantage in responsiveness and service over larger institutions.

Banking Conditions. Most members noted earnings challenges arising from COVID-19 impacts and related responses. They also described remarkable deposit growth and balance sheet expansion as a result of PPP, a flight to the safe haven of insured deposits, and other factors. These members said that these effects, coupled with the return to the near zero interest rate environment, resulted in net interest margin compression. Nearly all members reported increased deferrals and modifications, acknowledging that responses such as PPP had likely reduced the volume of these actions. Member Epstein stated that the *Interagency Statement on Loan Modifications and Reporting for Financial Institutions Working with Customers Affected by the Coronavirus* (FIL-36-2020) helped institutions to manage these activities. Members expressed some optimism regarding the number of borrowers in deferral already returning to current status, though many cautioned that the course of the COVID-19 pandemic and response will have a significant effect on future asset quality. Many members said that they were increasing

allowances for loan losses. A few members reported a reduction in capital ratios as a result of these conditions.

Bank Examinations. Several members mentioned recent FDIC examinations of their institutions, some completed without any onsite activity by examiners. All of these members praised the FDIC examination staff and leadership for showing great flexibility throughout the process. Member Pitkin stated the flexibility reflected the “tone from the top” at FDIC.

Minority Depository Institutions. Some members commented on the effects of the COVID-19 pandemic upon the minority communities. They expressed the important role of minority depository institutions in providing these communities with access to broader relief programs, such as the PPP. Member Kelly described his appreciation of communications he received from Chairman McWilliams and others in the wake of protests following George Floyd’s death. He also shared his belief that depository institutions have a role in addressing societal inequities in a capitalist economy.

Other Issues. Several members reported intense competition with credit unions, expressing their belief that tax-exempt status unfairly advantaged credit unions over banks. Member Messerschmitt reported completion of a merger in January and thanked the FDIC and the Iowa Banking Department for assistance in completing the transaction. Members from rural communities reported difficulties in growing loans and attracting management and staff in those localities.

Following the discussion of banking conditions by the Committee members, Mr. Davis introduced Shayna Olesiuk, Associate Director of National and Regional Risk Analysis, Division of Insurance and Research (“DIR”), Frank Hughes, Regional Director for the New York Region, and John Jilovec, Deputy Regional Director, Division of Risk Management Supervision (“RMS”), Kansas City Region, to continue the discussion of local banking conditions.

Ms. Olesiuk summarized FDIC views on the national economic conditions. First, she noted that the economy is clearly in recession, with the significant loss of 23 million jobs in March and April following the end of the economic expansion in February of this year. She observed that despite some recovery, the country remains in a net loss position. She noted regional concentrations in job losses in the Northeast, in the tourism-concentrated states of Florida, Nevada, and Hawaii, and in the Great Lakes’ manufacturing centers.

Ms. Olesiuk continued by noting that some economists are reporting the recession is technically over, with recovery to follow in the second half of 2020. However, she indicated that there is still a great deal of uncertainty, with significant concerns remaining regarding the course of the pandemic and weaknesses in the economy.

Ms. Olesiuk then turned over the presentation to Mr. Hughes and Mr. Jilovec.

Mr. Hughes continued the presentation with his report on the New York Region. He focused on the commercial real estate and multifamily sectors as well as banking conditions generally. At the outset, he noted that the New York Region was the center of the COVID-19 outbreak and led the nation with early closings that affected consumers, small businesses, and the retail and hospitality sectors.

Mr. Hughes said that the New York Region had higher concentrations of commercial real estate prior to the pandemic's outbreak, with concentrations in the multifamily sector. He said institutions in the Region had less on-balance sheet liquidity. As a result, he reported that supervisory efforts in the Region focused on risk management practices related to both liquidity and commercial real estate.

Mr. Hughes reported that, not surprisingly, the overall commercial real estate market contains some weaknesses. He reported that rent collections improved in June and July, up from May lows, but that some areas, such as the retail and hospitality sectors, are still showing material weaknesses. He noted the industrial sector's strength (nearly 100% of typical rents collected in July). He said the New York City hotel occupancy rate was 36%, up from 18% in early April but down from the 89% level for the same period last year.

Mr. Hughes said that the multifamily sector is experiencing small rental payment declines, however, these declines could be material for those properties with lower initial debt service coverage ratios. He further said that New York City's rent stabilized apartment owners reported that almost 25% of their tenants did not pay June rent. He noted that more than 10,000 apartments were listed for rent in Manhattan in June, an increase of 85% over last year. The apartment vacancy rate also hit a record 3.67% in New York City, but outside of the urban centers demand for apartments is great.

Regarding liquidity, Mr. Hughes reported increased on-balance sheet liquidity, which he attributed to stimulus checks, increased saving, decreased spending, and PPP advances that were deposited in bank accounts. He concluded by saying that the New York Region's banks had entered the recession strong, with good liquidity and capital metrics and satisfactory risk management practices. He noted that earnings are a continuing challenge for banks in the New York Region, with provision expenses and net interest margin compression contributing to difficulties this year.

Mr. Hughes then turned over the presentation to Mr. Jilovec, who presented on the agricultural sector in the Kansas City Region. First, he noted that the sector had enjoyed a supercycle of favorable yields and prices that concluded in 2013. According to Mr. Jilovec, since that time, commodity prices have been generally depressed with some areas affected more than others. He said the pandemic added challenges across the board, including supply chain disruptions in the food delivery system, COVID-19 cluster infections in processing plants, and

reduced consumption of motor fuels, resulting in lower demand for corn, which is used to produce ethanol.

Mr. Jilovec did note some positive factors affecting the sector. He pointed out the incredible support provided by government programs, which are projected to amount to 25% of 2019 net farm income. He noted that this support increased in 2020, with the CARES Act bringing an additional $16 billion in support, $2.5 billion of which had already been distributed in the Kansas City Region. Mr. Jilovec also identified resilient farmland values as a sector strength that enabled bankers and producers to continue through a distressed farm economy. He expressed concerns though, noting that seven years of depressed commodity prices have diminished equity and raised debt to levels that may be impossible for some producers to service. He described rising Chapter 12 farm bankruptcies as an indication of distress, but noted that they remain at a low absolute level relative to the total number of farms. Mr. Jilovec also pointed to increasing delinquencies in loans by agricultural banks, again to a relatively low absolute number. He contrasted the delinquency rate during the high point of the agriculture supercycle of 0.13% with the first quarter 2020 rate of 1.05%. Mr. Jilovec complimented bankers on managing their portfolios and working with distressed borrowers. Mr. Jilovec concluded on an optimistic note, stating that the overall condition of agriculture-focused banks remains relatively healthy.

Following this discussion, Mr. Davis announced that the meeting would briefly recess. Accordingly, the meeting stood in recess at 3:06 pm.

The Committee reconvened at 3:11 pm. After welcoming everyone back from the break, Mr. Davis introduced Betty Rudolph, National Director for Minority and Community Banking and Member Narvaez to provide an update on the Minority Depository Institutions ("MDI") Subcommittee.

Ms. Rudolph began by explaining that the FDIC established the MDI Subcommittee under the authority of the CBAC to provide a platform for MDIs to give feedback on the FDIC's strategies to fulfill its five statutory goals for MDIs (which were established in Section 308 of the Financial Institutions Reform, Recovery and Enforcement Act of 1989); to provide a platform for MDIs to promote collaboration, partnerships, and best practices; and to identify ways to highlight the work of MDIs in their communities.

Ms. Rudolph reported that the MDI Subcommittee is composed of nine MDI executives, who represent a diverse range of MDIs including African American, Hispanic, Asian American, and Native American institutions differing in business model, size, and location. She noted that the nine members of the MDI Subcommittee represent about 10 percent of all 96 MDIs supervised by the FDIC. She also noted that three MDI executives, Member Kelly, Member Beshear, and Member Narvaez, serve as members of the CBAC.

Next, Ms. Rudolph reported that the MDI Subcommittee held its inaugural meeting in December 2019, and then recently met again on July 27, 2020. At both meetings, a key topic was

the update of the FDIC's statement of policy regarding minority depository institutions. She explained that the purpose of the policy statement is to reflect the FDIC Board's commitment to fulfilling its statutory goals to preserve and promote MDIs and to provide the framework for the MDI program across the agency. Ms. Rudolph stated that changes to the policy statement demonstrate the FDIC's strengthened commitment to MDIs. She then introduced Member Narvaez to discuss the proposed key changes to the policy statement.

Member Narvaez began by explaining that the FDIC requested feedback from the Subcommittee on the policy statement that governs the MDI program. He highlighted three key changes to the draft policy statement. First, the draft policy statement includes a new engagement section that discusses the many ways the FDIC engages with MDIs, including interaction with the MDI Subcommittee.

The second change, he said, is to measure the MDI program's effectiveness. To accomplish this, the FDIC will conduct an annual survey of MDI executives to receive feedback on the effectiveness of the program activities such as technical assistance, training and education, and outreach. Member Narvaez explained that the draft policy statement now includes definitions for each of these activities. He noted that the MDI Subcommittee had the opportunity to review the 2019-2020 survey results, which show that the FDIC met 11 of its 12 goals for effectiveness of program activities and, overall, the combined satisfaction rate for MDI executives was 88 percent.

Next, Member Narvaez reported that the third change to the draft policy statement is to articulate the FDIC's examination approach on how the FDIC considers an institution's unique business model relative to examination standards. He noted that under the uniform examination standards, the FDIC conducts all examinations within the parameters of outstanding guidance. Member Narvaez explained that examiners measure the risk to the Deposit Insurance Fund and take into account each bank's risk profile, size, sophistication, and the nature and complexity of its business activities. Member Narvaez noted that the policy statement highlights that peer comparisons are not included in the rating system.

Member Narvaez reported that the MDI Subcommittee supports these updates to the policy statement. In addition, he noted that in December, the MDI Subcommittee provided feedback that the FDIC should update its description of its technical assistance program. The updates should highlight the ongoing nature of technical assistance that an MDI can request, at any point in the exam cycle, to better understand regulations, FDIC policies, examination procedures, accounting practices, and supervisory recommendations. He explained that the prior policy statement emphasized technical assistance provided 90 to 120 days after an exam. He noted that following the discussion the FDIC clarified that technical assistance is a tool to provide ongoing support to institutions. Also, he said the FDIC clarified that technical assistance is not a supervisory activity and is not intended to present additional regulatory burden.

Member Narvaez reported that the MDI Subcommittee understands that the FDIC intends to present the updated policy statement for consideration at an upcoming meeting of its Board of Directors. If approved, he explained, the FDIC will publish it in the *Federal Register* for public comment over a 60-day period. FDIC staff will then review and analyze public comments and present a final policy statement to the FDIC Board of Directors for its consideration. Member Narvaez said that MDI Subcommittee recommends that the FDIC move forward with the strengthened policy statement regarding minority depository institutions.

Member Narvaez concluded his discussion by thanking the Committee and welcomed any comments or questions. Mr. Davis then touched on the interaction between the Committee and the MDI Subcommittee. He noted that the objective of the Committee discussion of the draft statement of policy was to establish whether there is a consensus within the Committee to move the recommendation to the FDIC.

Member Epstein expressed his appreciation and support for the recommendations from the Subcommittee. Member Kelly then voiced his full support for the MDI Subcommittee's recommended changes to the policy statement. Based on their support as well as statements of support expressed through the meeting chat function, Mr. Davis then noted a consensus of the Committee to move the MDI Subcommittee recommendation regarding the draft statement of policy forward to the FDIC.

Mr. Davis introduced the next item on the agenda, which was an update on several supervision matters. Presentations were delivered by Doreen Eberley, Director, RMS; John Rieger, Chief Accountant, RMS; Rae-Ann Miller, Associate Director, Risk Management Policy Branch, RMS; Bobby Bean, Associate Director, Capital Markets Branch, RMS; and Leonard Chanin, Deputy to the Chairman for Consumer Protection and Innovation.

Ms. Eberley began by acknowledging the difficulties community banks described working through during the pandemic, and she reiterated her appreciation for how they adjusted their operations and for their understanding regarding how the FDIC supervisory operations also had to change.

Ms. Eberley then introduced the rest of the supervisory panel and their topics: Ms. Miller and Mr. Rieger would talk about appraisals, the recent examiner guidance relating to the pandemic, loan modifications, and regulatory reporting; Mr. Bean would cover modifications to the community bank leverage ratio ("CBLR") framework; and Mr. Chanin would talk about the guidance on small-dollar loans.

Mr. Rieger discussed FIL-36-2020, which encourages institutions to work constructively with borrowers affected by COVID-19, and notifies institutions that the agencies will not criticize supervised institutions for prudent loan modifications. He said the interagency document offers direction both from an accounting perspective and from a credit risk reporting perspective.

In addition, Mr. Rieger said that while the agencies want examiners to consider the unique, evolving, and potentially long-term nature of this environment, agencies need examiners to continue to assess institutions in accordance with existing policies and procedures and to provide supervisory feedback or downgrades on an institution's composite or component ratings when conditions have deteriorated.

Mr. Rieger noted that examiners will still consider whether institutions have managed risk appropriately, including taking appropriate actions in response to stresses caused by the COVID-19 impacts. He said examiners will consider the challenges in assessing risk and respond to the institutions in real time, given the level of information available and the stage of local economic recovery.

Next, Mr. Rieger discussed how the interagency statement describes accounting for pandemic-related loan modifications, including clarifying the interaction between accounting standards and the temporary relief provided by section 4013 of the CARES Act. The statement also provides supervisory views on past-due and nonaccrual regulatory reporting and regulatory capital considerations. He specified that institutions should not report those loans captured in section 4013 as past due or nonaccrual in their current reporting.

He described the two accounting methods available to financial institutions with regard to accounting under the CARES Act and under normal troubled debt restructuring ("TDR") accounting. Institutions may elect to account for an eligible loan modification under either: 1) section 4013 of the CARES Act; or 2) ASC Subtopic 310-40, *Receivables—Troubled Debt Restructurings by Creditors,* explained in FIL-36-2020.

Accounting under section 4013 of the CARES Act, he explained, does not require institutions to apply ASC Subtopic 310-40 to the loan modification. Mr. Rieger explained that if the customer is experiencing financial difficulty and the institution grants the concession, the institution does not have to report such loans as TDRs in regulatory reports. According to Mr. Rieger, the institution does not need to determine impairment associated with certain concessions that would otherwise have been required for TDRs, such as interest rate concessions, payment deferrals, or loan extensions. However, Mr. Rieger said institutions should maintain records of the volume of section 4013 loans, and they should continue to maintain an appropriate allowance for loan and lease losses, or allowance for credit losses, as applicable. Mr. Rieger noted that one of the conditions of section 4013 is that the loan must have been current as of December 31, 2019. He said additional information can be found in supplemental instructions available on the website of the Federal Financial Institutions Examination Council ("FFIEC").

Mr. Rieger said that the second method institutions can use for accounting under the CARES Act is to presume that borrowers affected by COVID-19, who receive short-term modifications and are current on payments, are not experiencing financial difficulties for purposes of determining TDR status. If modification is performed as part of the program, he said, no further TDR analysis is required for each loan modification in the program. Under this criteria, he explained, the modification should be short term in nature (*e.g.*, six months) and made in good faith in response to COVID-19. Mr. Rieger said that borrowers must have been

current prior to any relief, which means less than 30 days past due on their contractual payments at the time the modification was implemented.

Having discussed the accounting perspective, Mr. Rieger next turned to risk management and regulatory risk ratings for classifications, as a separate and distinct decision from TDR determination. He said that regulatory risk ratings remain governed by all existing guidance and policy for determining creditworthiness of borrowers. Examiners will exercise judgment in reviewing loan modifications and will not automatically adversely risk grade credits that are affected by COVID-19, according to Mr. Rieger.

Concluding his remarks, Mr. Rieger emphasized that examiners will not criticize prudent efforts to modify the terms on existing loans to affected customers.

Ms. Miller then discussed the financial institution letter issued on June 23, 2020, titled *Interagency Examiner Guidance for Assessing Safety and Soundness Considering the Effect of the COVID-19 Pandemic on Institutions* (FIL-64-2020). She said that the FIL promotes consistency across the agencies and flexibility in the supervision and examination of institutions. The FIL acknowledges that stresses caused by COVID-19 can impact financial and operational conditions, even when management has appropriate governance and risk management systems in place to identify, monitor, and control risk.

Ms. Miller emphasized that this interagency guidance is for examiners, not banks, and requires no action by banks. She explained the agencies wanted to ensure their guidance to examiners was consistent across the agencies, regions and local offices given how deeply the pandemic event is reaching into our communities.

She cited relevant experience on a smaller scale, and similar guidance documents issued to examiners: for example, when the hurricane in Puerto Rico approximately two years ago caused physical dislocations and damage to properties that were out of the banks' control. She said that the question was how to examine a bank in that type of situation, though she acknowledged the pandemic has a much broader impact. Ms. Miller described how, in those guidance documents to examiners and in this one, the agencies acknowledged certain external factors can hurt institutions even when they have good risk management practices and are doing whatever is necessary to correct and manage the situation.

Next, Ms. Miller noted that the guidance instructs examiners to consider the unique, evolving, and potentially long-term nature of the issues confronting institutions and exercise flexibility in their supervisory response. It also instructs examiners to assess institutions in accordance with existing policies and procedures and provide feedback, or downgrade ratings, when conditions have deteriorated.

She pointed out that examiners will continue to assess institutions in accordance with existing policies and practices, including the interagency CAMELS rating system, or Uniform Financial Institutions Rating System ("UFIRS"). She reiterated that all the UFIRS components consider not only financial condition, but also risk management practices.

She highlighted how the guidance instructs examiners to consider whether institution management has managed risk appropriately, including taking appropriate actions in response to the pandemic. It also instructs examiners to consider the challenges involved in assessing risk in real time given the level of information available and the stage of local economic recovery and to consider the institution's asset size, complexity, risk profile, and business focus of customers. In sum, Ms. Miller said examiners would focus on risk management, risk assessment, and plans to deal with the situation, understanding that sometimes there is a void in information.

Next, Mr. Bean discussed the CBLR. He started by noting that the interagency rule was issued in late 2019 with an effective date of the first quarter 2020. Mr. Bean said that as of the last quarterly filing, 39 percent of all eligible institutions (about 1,710 institutions) had elected to apply the CBLR. He added the near 40 percent figure was encouraging as this was the first quarter this was available. Then, Mr. Bean discussed the temporary changes to the CBLR. On April 23, 2020, the agencies published in the *Federal Register* two interim final rules ("IFRs") that make temporary changes to the CBLR, to take effect in the second quarter of 2020.

Mr. Bean explained that a modification to the CBLR allows the agencies to drop the required CBLR to eight percent for the duration of the pandemic. He said the agencies were concerned about the sudden increase in the CBLR from eight to nine percent that would occur once the national emergency was declared lifted. Consequently, he said, the CBLR interim final rules issued in April make two key contemporaneous changes. The CBLR will be 8 percent beginning in the second quarter and for the remainder of calendar year 2020, 8.5 percent for calendar year 2021, and 9 percent thereafter. Mr. Bean said the agencies thought this transition period was important for institutions to appropriately plan their capital, by allowing institutions to foresee potential losses and to plan to build the CBLR gradually over a two-year period. Mr. Bean said that the FDIC received one comment that supported the IFRs. Accordingly, the agencies plan to move forward on the CBLR as discussed.

Ms. Miller then discussed appraisals and evaluations. She said soon after the pandemic began, the FDIC started receiving questions about appraisals and evaluations and the restriction of movement upon appraisers.

In response, Ms. Miller said, two interagency steps were taken. First, as detailed in the financial institution letter issued April 14, 2020, titled *Facilitating Real Estate-Related Transactions Affected by COVID-19* (FIL-43-2020), the agencies issued an interim final rule creating a temporary provision allowing institutions to defer appraisals for federally-related commercial and residential real estate loans. Ms. Miller said the agencies wanted to issue the appraisal deferral quickly, to ensure that appraisal issues would not hold up getting capital into the hands of creditworthy borrowers. She noted that acquisition, development, and construction loans were not included in this temporary appraisal deferral.

Ms. Miller said the temporary appraisal deferral will expire on December 31, 2020, unless extended by the federal banking agencies. She noted that the IFR provides that examiners will assess whether institutions made an effort to determine a valuation of the real property based on existing information or information available electronically or otherwise to the institution.

Ms. Miller described the second action the agencies took, on the same day, which was to issue an interagency statement on some existing flexibilities in regulations. The statement advised institutions of temporary changes to Fannie Mae and Freddie Mac's appraisal standards that can assist lenders. The interagency statement also discussed flexibilities available in the Uniform Standards of Professional Appraisal Practice ("USPAP") and in the agencies' existing appraisal regulations. For instance, USPAP does not actually require a physical inspection of property, and the agencies wanted to ensure awareness of this fact. The statement also highlighted exceptions to the requirement for an appraisal by a certified or licensed appraiser that existed in the interagency appraisal regulations. For example, residential real estate transactions with a transaction value of $400,000 or less and commercial real estate transactions with a transaction value of $500,000 or less already are exempted from the appraisal requirement.

Mr. Rieger then discussed some pandemic-related revisions to instructions for Consolidated Reports of Condition and Income ("Call Reports"). He explained that on July 10, 2020, the FFIEC issued a financial institution letter titled *Consolidated Reports of Condition and Income for Second Quarter 2020* (FIL-69-2020). The FIL states that the June 30, 2020 Call Report would include revisions associated with several of the interim rules and a final rule issued by one or all of the agencies in response to the impact on the financial markets and the strains on the U.S. economy as a result of the pandemic. Mr. Rieger noted that institutions should refer to the separate standalone June 2020 COVID-19 Related Supplemental Instructions addressing these revisions. Next, Mr. Rieger focused on specific new data items required as a result of the CARES Act. The new items, he said, take effect for the June 30, 2020 Call Report. Specifically, he noted eligible loan modifications under section 4013 (temporary relief from troubled debt restructuring of the 2020 CARES Act), PPP loans, loans under the Federal Reserve PPP Liquidity Facility ("PPPLF"), and asset holdings purchased under the Money Market Mutual Fund Liquidity Facility ("MMMLF").

As the final presenter in the Supervision Update panel, Mr. Chanin discussed interagency lending principles for offering responsible small-dollar loans. He said the FDIC began looking at small-dollar lending before the pandemic, after financial institutions suggested that existing guidance was not encouraging them to make responsible small dollar loans. Consequently, he said, on March 26, 2020, the FDIC and other banking agencies issued a short statement encouraging institutions to offer responsible small-dollar loans to consumers and small businesses and noted more detailed guidance would follow in the coming months (FIL-26-2020).

Mr. Chanin reported that additional guidance was issued on May 20, 2020 (FIL-58-2020). He described it as "high-level guidance," since it does not detail, for example, the types of products that institutions should offer. He noted that the guidance mentions that institutions may want to consider installment loans, lines of credit, or other products that best suit their customers' needs. Presentation materials described principles for offering small-dollar loans: ensure products are consistent with safe-and-sound banking; treat customers fairly; comply with applicable laws and regulations; manage the risks associated with offered products, including credit, operational, and compliance; and underwrite based on prudent policies and practices governing the amounts borrowed, frequency of borrowing, and repayment requirement.

Mr. Chanin emphasized the guidance also mentions structuring loans with repayment terms that encourage or enable borrower affordability, *i.e.*, that enable borrowers to have successful repayment plans under the terms of the transaction. He added that the guidance highlights credit underwriting and the need to assess consumer creditworthiness. Mr. Chanin explained that the agencies hope to encourage institutions to provide small dollar loans to their customers and make the loans available to potential customers as well as to add competition to the market.

Ms. Miller then opened up the discussion to the Committee for comments and questions.

Member Epstein asked about additional loan modifications for customers who previously had payments deferred, then resumed making payments, but needed additional modifications due to circumstances beyond their control. Ms. Miller responded that the FDIC encourages institutions to work with customers. She noted that Section 4013 of the CARES Act generally allows institutions to not report the modified loans as TDRs, though it does not eliminate the requirement to evaluate risk and maintain an appropriate allowance.

Member Epstein explained further that institutions are simply concerned that multiple modifications would indicate a recurring problem when it was actually a matter beyond the borrower's control. Mr. Rieger added that many institutions have done short-term modifications so they can stay closer to their customers. If a borrower received multiple deferrals within the emergency period, he said, they would still qualify for that relief – the institution would still not need to disclose that as a TDR.

Member Leavitt asked Ms. Miller to comment on FDIC modeling of prolonged pandemic conditions and perhaps mounting bank failures. Ms. Miller responded that the FDIC uses a number of models to review institutions off-site. She highlighted models that flag institutions for growth or liquidity issues. She also noted review of institutions with concentrations in industries that may have been hit hard. Ms. Eberley added that given the current uncertainties, the FDIC continues to carefully monitor conditions and engage in dialogue with institutions.

Following this discussion, Mr. Davis announced that the meeting would briefly recess. Accordingly, the meeting stood in recess at 4:09 pm.

The Committee reconvened at 4:20 pm. Mr. Davis introduced Richard Jones, Chairman; Susan Cosper, Board Member; and Shayne Kuhaneck, Acting Technical Director of the Financial Accounting Standards Board ("FASB") to provide an Update on the Current Expected Credit Losses Standard ("CECL").

Mr. Jones began by thanking FDIC for the opportunity to participate. He introduced his co-panelists, noting Ms. Cosper's background in community bank auditing.

As background, Mr. Jones noted that FASB is responsible for setting GAAP rules for use by investors and lenders in capital allocation, but they do not set regulatory capital rules. He acknowledged that banking regulators do use FASB's standards.

He then discussed the phased approach to CECL implementation, which he said started with public companies followed by private companies three years later. He noted that the purpose of this was to provide an opportunity to learn from adoption of the public companies before the private companies adopted, so that FASB, as standard setters, could identify whether there were areas where they needed to take action. Mr. Jones described the stakeholders involved in this post-implementation review by FASB, and he noted that large standards often require fine-tuning. Given term limits for the members of the FASB Board, he stated that only one current FASB Board member had voted for CECL when the standard was adopted. He noted that the purposeful design of the FASB Board's composition allows for a "fresh look" at standards. He said he therefore welcomed questions and concerns about CECL, and he was interested in hearing whether concerns were cost- or outcome-related, and if they were outcome-related whether Committee members viewed them as regulatory capital or financial reporting issues.

Member Leavitt commented that his bank has not yet adopted the CECL standard and that building new factors, such as a pandemic, into their general reserves currently relies "more on art versus science." He asked whether the FASB panelists had comments on the challenge of unexpected events such as the pandemic. Mr. Jones acknowledged that the environment is not what FASB expected, but noted that CECL's proponents maintained that, in addition to providing transparency, CECL enabled allowances and losses to be taken earlier in the cycle versus toward the end and that management was in the best position to estimate those lifetime losses. Ms. Cosper commented on the subjectivity that banks are dealing with today in applying the incurred-loss model. She added that, as banks move forward with CECL, they will still have to make estimates based on individual facts and circumstances, such as the market the bank operates in and its customers.

Mr. Jones closed the CECL discussion by encouraging Committee members to contact him and FASB with comments regarding CECL.

Mr. Davis thanked the FASB panelists for their participation and then invited Claire Lam, Acting Director of the FDIC's Office of Minority and Women Inclusion ("OMWI"), to make a presentation on Diversity and Inclusion at Financial Institutions.

Ms. Lam began her presentation by providing background on the FDIC's Financial Institution Diversity Program. She noted that the program is rooted in the requirement in the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 that the financial regulatory agencies' Offices of Minority and Women Inclusion develop standards to assess the diversity policies and practices of the financial institutions that they regulate.

Ms. Lam reported that the FDIC, along with other regulators, issued a Policy Statement in 2015 containing standards that provide the framework for financial institutions to self-assess their diversity policies and practices. The standards, she reported, identify five key areas for

advancing diversity and inclusion within an organization and were the result of roundtable discussions held with the financial services industry.

She noted that the FDIC encourages its regulated entities that have 100 or more employees to conduct a self-assessment annually and to voluntarily share the results with the FDIC so that trends may be shared across the industry. Ms. Lam remarked that financial institutions, regardless of size, can benefit from a diversity self-assessment because a diverse workforce and an inclusive culture help financial institutions to connect with the local community and an increasingly diverse customer base.

Ms. Lam described the FDIC's Financial Institution Diversity ("FID") program as having three overarching strategic goals. She said it seeks to create and strengthen partnerships with financial institutions, with the ultimate goal of helping them mature their diversity and inclusion programs. She also said that the FID program aims to leverage technology in order to make it as easy as possible for banks to conduct self-assessments. Lastly, the FID program seeks to promote and share the benefits of diversity and inclusion for financial institutions.

Ms. Lam touched on the development of resources, based on what banks share with the FDIC in their diversity self-assessments, as these resources will help banks improve their diversity and inclusion programs and practices. Ms. Lam said that, upon seeing an area of challenge across the industry, the FDIC can start to research and share information aimed at helping banks to better address and overcome those challenges. As an example, Ms. Lam reported that the FDIC recently developed and posted on its website white papers that serve as resources to support financial institutions in developing and maturing diversity policies and practices.

Ms. Lam then introduced the Financial Institution Diversity Self-Assessment application, ("FID-SA"), accessible through a secure portal within the FDIC*connect* system. She stated FID-SA was developed to facilitate the collection of self-assessment information and allows financial institutions to submit electronically the self-assessment data. She identified the improvements over the prior system of fillable PDFs, including the ability of institutions to access their data and an improved ability by the FDIC to perform trend analysis using aggregate data. She repeated the FDIC's encouragement to banks with more than 100 employees to use the FID-SA to conduct and voluntarily submit a self-assessment. Using the self-assessment tool, she said, allows community bankers to measure how their institution's data aligns against other institutions of similar size, location, and practices; highlight their diversity and inclusion successes; increase awareness of challenges; and identify opportunities to proactively and strategically improve and grow diversity and inclusion practices. She also encouraged community banks to use the previously described diversity and inclusion framework in a manner that is appropriate to their size, governance structure, and characteristics.

Ms. Lam next discussed challenges facing community banks. These included difficulties posed by size and location, particularly rural banks. She noted that, regardless of size, practices from larger institutions can be scaled down for application to community banks. She also identified the self-assessment as the single most important tool in identifying a baseline towards improvement and encouraged bankers to work with OMWI in implementing their diversity and inclusion programs. She emphasized the confidential treatment of FID-SA data, and again noted that it is analyzed only in the aggregate.

Ms. Lam next discussed examples of successful diversity and inclusion practices, some of which were reported in the FDIC's Section 342 annual report highlights. Among the items she reported were employee development programs targeted to developing women and minorities for leadership positions; diversity and inclusion scorecards in management dashboards; and staff training at all levels, both voluntary and mandatory, to enhance employee awareness about diversity and inclusion issues in the workplace. According to Ms. Lam, many banks have also reported incorporating diversity and inclusion in their leadership and management development curriculums and hiring student interns, providing them with opportunities for full- or part-time employment. Other reported strategies include supplier diversity; incorporating components of diversity and inclusion into corporate goals; and adding diversity and inclusion into the performance standards of the senior management team. She noted that the last two items demonstrate a commitment to organizational and individual accountability, which provide the catalyst towards driving the change needed to achieve diversity and inclusion goals.

Member Kelly responded to Ms. Lam's invitation for comments and questions by expressing his appreciation for having this topic on the agenda, as it is an important topic. He reiterated his earlier comments that bankers have a duty to lead in this area. He appealed to his colleagues to think about how they can contribute to these efforts. Member Kelly noted that diversity and inclusion benchmarks should be set with local conditions in mind.

He commended Chairman McWilliams and Director Gruenberg for their efforts in this area. Ms. Lam thanked him for these comments and noted that, while diversity and inclusion cannot be mandated, studies have demonstrated the benefits of pursuing it.

Ms. Lam closed by noting that diversity and inclusion is a challenging topic and the FDIC remains committed in supporting the diversity and inclusion needs of community bankers. She suggested that bankers review the completed analyses and reports that have been prepared for prior years and again encouraged bankers to consider conducting a diversity self-assessment for 2020 and sharing the results with the FDIC. She also welcomed feedback on how the FDIC can better support community bank efforts regarding diversity and inclusion.

Mr. Davis then turned to Ashley Mihalik, Chief, Banking and Regulatory Policy Section,

DIR, and Yan Lee, Economist, Special Studies Section, DIR for a Division of Insurance and Research Update regarding a recent rulemaking on deposit insurance assessments as well as the results of a recent survey on small business lending.

Ms. Mihalik provided the update on the final rule that mitigates the deposit insurance assessment effects of participating in the PPP, PPPLF, and MMLF, approved by the Board on June 22, 2020. She said the rule ensures that banks will not be subject to significantly higher deposit insurance assessments for participating in these programs.

After providing background on the assessment mechanism, Ms. Mihalik explained that, under the final rule, the FDIC will exclude PPP loans from an insured depository institution's ("IDI") total assets and will exclude borrowings under the PPPLF from an IDI's total liabilities in risk measures used to determine an institution's assessment rate. She said the final rule also mitigates the effect of assets purchased under the MMLF increasing an institution's assessment base. The rule allows an offset that is equal to the increase in its assessment base due to participation in the PPP and MMLF. Ms. Mihalik noted that, in addition, the FDIC will exclude all PPP loans and assets purchased under the MMLF from total assets in calculating certain adjustments that reference a bank's assessment base and in classifying IDIs as small, large, or highly complex for assessment purposes. This means that a small bank would not be reclassified as large solely due to participation in the PPP or MMLF.

Ms. Mihalik closed by explaining implementation of the rule, calling attention to the FDIC's public website calculators to be posted in August.

Ms. Lee then continued the DIR presentation with a review of the FDIC's staff study, "Measurement of Small Business Lending Using Call Reports: Further Insights from the Small Business Lending Survey," published in July 2020. She introduced this study as an examination of how useful Call Report data is in measuring small business lending by community banks.

Ms. Lee provided a description of the 2016 Small Business Lending Survey and referenced a 2018 FDIC report on the data collected. She said the FDIC viewed community banks as well-placed to make economically beneficial loans to small business, so the agency has an interest in collecting data on this lending. She presented a chart depicting how true small business lending – small and larger loans to small businesses – can be lost in Call Report data on commercial and industrial loans. Ms. Lee showed how survey results could be used to more accurately measure small business lending.

Ms. Lee closed by explaining DIR's data collection efforts for 2022, which includes prior subjects plus exploration of the COVID-19 response, bank use of FinTech, loan decision making, and SBA lending. She outlined the schedule for future surveys and encouraged bankers to respond.

Member Shettlesworth, at Mr. Davis's invitation, expressed interest in participating in the survey. He also suggested capturing loan data by zip code to identify mismatches between deposit collections and lending activities. Ms. Lee responded that the Consumer Financial Protection Bureau has a mandate to determine whether to collect lending data with precise geographic indicators.

Mr. Davis then introduced Mr. Milhorn, Deputy to the Chairman and Chief of Staff, to present the FDIC's Rapid Prototyping Technology Competition.

Mr. Milhorn began by referencing his prior comments about the Supervision Modernization Subcommittee and its goal regarding using technology to improve effectiveness and efficiency of supervision while reducing regulatory burden and cost on institutions, particularly community banks. Toward those ends, he noted the recent launch of the FDIC's Rapid Prototyping Technology Competition.

He said the competition involves 30 firms that are leaders in the financial services, data management, data analytics, and artificial intelligence/machine learning fields. According to Mr. Milhorn, these competitors are developing methods of accessing data at financial institutions to better understand the health of the individual institutions and the overall industry without regard to the data format, structure, or sources. He said that this acknowledges that the data resides in multiple locations and formats, which poses a challenge to automating reporting and completing Call Reports.

The rapid prototyping acquisition method, as described by Mr. Milhorn, involves providing experienced firms with a challenge to deliver a solution in a competitive environment, rather than a set of requirements. He expressed hope that this would yield "ingenious solutions." He said competitors will first deliver concept papers, to be followed ninety days later with demonstrations, with prototypes to follow ninety days thereafter. He referenced Chairman McWilliams's statements in the *American Banker* regarding "making the Call Report obsolete" and said that while this competition will not achieve that end within 180 days, it could provide a foundation for a better supervisory model that relies on targeted data to assess the health of institutions.

Mr. Milhorn said the technology demonstration would not require institutions to produce data sets or participate in the process. Rather, he reported, participation will be voluntary. He said he hoped that the rapid prototyping would provide solutions for improving FDIC supervision and addressing institutions' regulatory reporting, as well as helping institutions more effectively onboard and use technology.

Member Shettlesworth responded to Mr. Milhorn's call for questions by expressing preference for a system that relies on uploads from the institution's core systems rather than manual reporting. Mr. Milhorn responded that this was very close to the goal of the competition

of seamlessly accessing the data where it sits without imposition of additional burden, and developing the capability to conduct analysis on data between exams to identify risk early on.

Member Walker volunteered her institution to participate in the competition, which Mr. Milhorn welcomed.

Member Getzlaff commented that her institution at times needs to upload files to the Federal Reserve Bank; however, the upload requires data fields that are not captured in their core system. As a result, her bank must review files to obtain that information. She requested that the FDIC identify in advance the information that will be required to avoid this. In response, Mr. Milhorn said that the goal was to take the data as it exists and achieve high quality analysis without imposing format and content requirements on institutions.

This concluded Mr. Milhorn's presentation. Mr. Davis then turned to Director Gruenberg for remarks.

Director Gruenberg thanked the Committee members for participation and their helpful and insightful contributions. He expressed his view that the next 12 to 18 months will be extraordinary times of challenge and stress for the banking and financial system. He said he hoped to continue to benefit from the Committee's insights throughout this period.

Mr. Davis then turned the meeting over to Chairman McWilliams to close the meeting.

Prior to adjourning the meeting, Chairman McWilliams echoed Director Gruenberg's comments regarding the extraordinary times. She expressed hope for the pandemic's ending, and exhorted Committee members to continue to support their communities. She thanked Committee members for their contributions to this meeting. She also thanked former member Chris Donnelly, President and CEO of Bank of the Prairie, for the time and effort he contributed to the work of the Committee.

Chairman McWilliams then adjourned the meeting.

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Robert E. Feldman
Federal Deposit Insurance Corporation
Executive Secretary
and Committee Management Officer
FDIC Advisory Committee on Community Banking

July 28, 2020

Minutes

of the

Meeting of the FDIC Advisory Committee on Community Banking

of the

Federal Deposit Insurance Corporation

Held in the Board Room

Federal Deposit Insurance Corporation Building

Washington, D.C.

Open to Public Observation Via Webcast

July 28, 2020 – 1:00 P.M.

I hereby certify that, to the best of my knowledge, the attached minutes are accurate and complete.

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Jelena McWilliams
Chairman
Board of Directors
Federal Deposit Insurance Corporation

July 28, 2020