

FEDERAL DEPOSIT INSURANCE CORPORATION

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ADVISORY COMMITTEE ON COMMUNITY BANKING

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MEETING

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WEDNESDAY,
OCTOBER 26, 2022

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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, Acting Chairman, presiding.

PRESENT:

- MIKE BOCK, CEO, Dairy State Bank, Rice Lake, Wisconsin
- TROY CAMPBELL, President and CEO, Altoona First Savings Bank, Altoona, Pennsylvania
- ANTHONY CAPOBIANCO, President and CEO, American Community Bank, Glen Cove, New York
- HAROLD HORVAT, President, CEO and Chairman, Centreville Bank, West Warwick, Rhode Island
- ROBERT JAMES II, Executive Vice President, Carver State Bank, Savannah, Georgia
- BETSY JOHNSON, President and CEO, Solutions Bank, Forreston, Illinois
- CINDY KITNER, President and CEO, Jefferson Security Bank, Shepherdstown, West Virginia
- BRUCE LOWRY, President and CEO, Ireland Bank, Malad City, Idaho
- TREY MAUST, Executive Chairman, Lewis & Clark Bank, Oregon City, Oregon

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NEIL MCCURRY, JR., Sarasota and Manatee County
Market President, Seacoast National Bank, Stuart,
Florida

DOMINIK MJARTAN, President and CEO, OPTUS Bank,
Columbia, South Carolina

GILBERT NARVAEZ, JR., President and CEO, Falcon
International Bank, Laredo, Texas

ARLEN OSTERBUHR, Chairman and CEO, Minden
Exchange Bank and Trust Company, Minden, Nebraska

SHANE PILARSKI, President and CEO, Alliance Bank,
Francesville, Indiana

KIM REIGELBERGER, President, Preferred Bank,
Rothville, Missouri

ANDREW WEST, President and CEO, Eagle Bank,
Polson, Montana

JOHN WHARTON V, President and CEO, Yampa Valley
Bank, Steamboat Springs, Colorado

ALSO PRESENT:

MARTIN J. GRUENBERG, Acting Chairman, Federal
Deposit Insurance Corporation

MICHAEL J. HSU, Acting Comptroller of the
Currency

DOREEN EBERLEY, Director, Division of Risk
Management Supervision

G. CHRIS FINNEGAN, Senior Deputy Director,
Division of Depositor and Consumer Protection

DANIEL HOOPLE, Chief, Fund Analysis and Pricing
Section, Division of Insurance and Research

ANTHONY LOWE, FDIC Ombudsman

THOMAS LYONS, Associate Director, Division of
Risk Management Supervision

JONATHAN MILLER, Deputy Director, Division of
Depositor and Consumer Protection

SHAYNA OLESIUK, Deputy Director, Division of
Insurance and Research

BETTY RUDOLPH, Director, Office of Minority and
Community Development Banking

CAMILLE SCHMIDT, Section Chief, Division of Risk
Management Supervision

MICHAEL SPENCER, Associate Director, Division of
Insurance and Research

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

9:00 a.m.

ACTING CHAIRMAN GRUENBERG: Good morning, everyone. We've got a full agenda today, and I think people will be particularly interested to hear comments on the --

(Off-microphone comments.)

ACTING CHAIRMAN GRUENBERG: And the Fed has made a sharp turn in terms of the conduct of monetary policy, and we've had five increases in interest rates this year, declining GDP growth in the first and second quarter, and the Fed is signaling about as clearly as it can that they're going to pursue a tightening interest rate policy until they get inflationary pressures under control.

So, I think it's fair to expect that we're going to be looking at a rising interest rate environment and a slowing economy, and as we indicated in the QVP, significant downside risks for the U.S. banking industry going forward.

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That's, you know, a broad perspective. I'd be most interested in hearing what you're seeing thus far at the local level and how you're thinking about, quite frankly, the next six to 12 to 18 months. I think that would be, frankly, of great interest to us.

So, thank you all for being here. It should be an interesting discussion today. And if I may, let me turn the program over to Doreen Eberley who I'm sure many of you know. She's the Director of our Division of Risk Management Supervision. Doreen?

MS. EBERLEY: Thank you, Acting Chairman Gruenberg. Acting Comptroller Hsu, would you like to share any remarks before we begin? Okay.

ACTING CHAIRMAN GRUENBERG: Pardon, you know, it's the morning and really there's something --

(Laughter.)

DIRECTOR HSU: We see each other so

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much.

ACTING CHAIRMAN GRUENBERG: Well, that's something to that, quite frankly. We are really, frankly, honored to have one of our Board members here today, Mike Hsu, who is the Acting Comptroller of the Currency. Mike, are you sure you don't have any --

ACTING COMPTROLLER HSU: You said it, Marty. I mean, we spend so much time together, we got a bit of a mind meld on this. It's a very interesting time right now. I think there are some interesting challenges and opportunities for community banks.

So, we'd just really like to hear from you directly about this because we observe things from afar a bit, and so having meetings like this is just really, really valuable. Thanks.

MS. EBERLEY: Okay, thank you so much. We're changing things up just a little bit this time, and for those of you who this is your first meeting, you won't know that, but what we're

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going to do this morning is start by turning to Shayna Olesiuk, Deputy Director of our Deposit Insurance and Risk Analysis in the Division of Insurance and Research, and Camille Schmidt, who is Chief of Risk Insights and Analytics Section in the Division of Risk Management Supervision.

And Shayna and Camille are going to provide an economic overview. They'll touch on market, liquidity, and credit risk. And throughout their presentation, we want to hear from the committee members regarding your thoughts on these risks, as well as others.

So, we do look forward to hearing from you as we work through the program about what you're seeing in your communities.

MS. OLESIUK: Thank you, Doreen, and it's so great to see all of you in person. I've seen many of you on the screen over the years and it's nice to be here in person.

So, I think in your packet, there's copies of the slides as well as the press release

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about our release of the risk review publication.

So, Camille and I, our teams worked together on our annual publication of the risk review, so we'll be using that publication and the topics that we talked about in that, in the most recent publication to sort of guide our discussion today.

As Doreen said, we'll be talking about three different topics, first starting with the economic overview, then market and liquidity risk, and finally credit risk.

So, I think we have about an hour and a half, so plenty of time to hear from all of you on these topics. So, Mike, we can go to the next slide.

So, starting off with the economic overview, it's definitely been an interesting time over the last several years related to the economy.

As the Acting Chairman said, you know, we're certainly seeing slowing on the output side

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of things, on economic growth there, but the picture for the labor markets is quite different and actually much more positive.

So, this map was for data through the end of December 2021. It's shaded based on the share of jobs recovery for each of the states. So, the numbers on the states give the percent of jobs lost during the early days of the pandemic, what percent of those have been regained.

So, the states that are shaded in gold are those that have recovered more than the nation. As you can see at the bottom of the legend there, the nation as of the end of last year had recovered 84 percent of the jobs lost during the early part of the pandemic.

So, the darkest gold are those that had fully recovered and more, those that are over 100 percent recovery. Gold is above the nation and then the blue are those that have trailed the nation, with the darkest blue being those that have had the slowest recovery.

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Now, this map was as of the end of last year. If we update this to the most current data that we have, the number of states that have fully recovered goes up to 24.

So, here we only had five states as of the end of last year that had recovered all of their jobs lost during the pandemic and now we're up to 24, so things have really accelerated just over the last several months.

And you certainly see regional patterns emerging in the Mountain West and in the South being those areas that, in some cases, lost the smallest number of jobs in the early part of the pandemic, but those are the areas that we've really seen growth emerging.

As far as the variance by industry, we still see some difference there. The transportation sector leads the way. We've seen lots of growth during the pandemic in various transportation areas. We were talking earlier this morning about how busy the ports are still

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serving the different logistics and distribution there.

And also, not shown on this map, but the unemployment rate is back down to pre-pandemic levels. It's at 3.5 percent as of September, so lots of -- well, and the labor force participation rate has also not reached its pre-pandemic level.

So, worker shortages are certainly an issue, as well as wages. Wages have increased in order to try to attract people to jobs, but wages are still trailing the pace of inflation. We can actually go to the next slide.

So, here, again this is the chart from the risk review showing data through the end of 2021 for CPI and Core CPI. Even back on this chart, the number, the current numbers looked very high and they've only climbed if we were to update this chart to current.

So, certainly a concern from our point of view on inflation, we're seeing now the main

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contributors to inflation being shelter costs, energy costs, and food costs. So, really across the board, inflation is hitting many parts of the economy.

And the outlook is really uncertain as far as, you know, all of the factors driving the high prices, things like supply chain issues. You know, that's not something that seems like it's going to be fixed quickly, so certainly a concern for many aspects, and so I think we can go to the next slide.

So, I will pause here, and we'll pause a couple of times during the discussion today to hear from all of you, so I'll open it up to anyone that wants to start the discussion, how your bank or how your area is being impacted by inflation, rising interest rates, and concerns about recession.

MEMBER JOHNSON: Thank you. Betsy Johnson from Northern Illinois. Of course, we have Chicago in our area which dictates a lot of

things and unemployment is not quite there. We're still one of the lag things around that, transportation.

Even I noticed when I started traveling in early 2022, you know, we had to wait for bags for two hours because the Southwest workers left, and trying to replace them with expertise even in that level, it's very tough, the same thing when it comes to our banks and trying to retain them and so forth.

So, unemployment is -- Illinois always lags a little bit behind. Inflation, things, it hits us all. We know that. What we're kind of worried about is just that, not only our sales, but all our small businesses.

And banking, we're a business, so that affects us. You talked about our employees, trying to retain them and get new employees. That's when everybody makes more money, when they change jobs, right, so that's what we're trying to retain.

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But we think our savers, that generation is a little bit extinct. We talked about that a little bit last night with some of you. And those people that save great and took their retirements and their CD interest and lived on that, I think we've kind of seen almost the end of those.

And what of our new generations of savers? They haven't felt the pain and I'm afraid they're going to feel the pain now, to feel that and maybe change their ways, but how do we help them do that because it affects all of us?

As far as our, I mean, agriculture is still good. Farmers always seem to sustain whether it's in the form of subsidiaries, subsidies, sorry, but it's still a very green area in our state there.

Manufacturing wise, there's some rumors that maybe a plant, Chrysler, in our area may be leaving, and that was experienced, the same experience -- we hope that's not the same

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experience as Wisconsin experienced in Janesville when GM left. It was try to -- it was quite an effect on the community, but now today, they're still thriving. I think it was about ten, 15 years ago.

So, those are just rumors, so don't go around saying things about that, please, but those are things you have to keep your eye on.

And there were some other things, so I'll give everybody else a chance, but I got it started.

PARTICIPANT: Thank you.

MEMBER JOHNSON: Thank you.

MEMBER HORVAT: Good morning. I'm Hal Horvat. I'm the CEO of Centreville Bank. We're based in Rhode Island. We're about \$2 billion in assets.

So, for us, it feels like the calm before the storm. Things are really good right now. We've had a record year in terms of our originations on our loan side. Our profitability

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is up. Our margins increased. Our efficiency ratio is better than it's ever been. And our credit quality has been, knock on wood, really, really pristine at this point in time.

So, we feel like things -- you know, if you look at our third quarter numbers, things look really good. We are concerned about how, you know, what's going to happen with the increase in interest rates, et cetera, and the potential for a significant recession, but we do feel pretty optimistic because we think that community banks like ours can really actually make some hay if things go bad in terms of a recession.

Oftentimes, you see some of the larger banks get out of the market and that's a time where you can pick up some good business, so we're well capitalized. We actually feel pretty good heading into this, what is going to be a pretty difficult time, so thank you.

MEMBER REIGELSBERGER: Hi, I'm -- I

think this is on? Kim Reigelsberger. I'm with Preferred Bank. We're in Rothville, Missouri. That's north central Missouri. We're basically an ag-related bank.

Thinking about what he just said, we are diversified, and not only do we have our agriculture, but we have -- but agriculture drives our economy locally. So, whether you're going to the grocery store or whether you're going to buy a new car, it's going to be -- the agriculture industry really helps keep that going.

And more recently, even though commodity prices in our area -- we have corn, soybeans, and cattle. That's the main things. Missouri is like the third largest state in the nation that has we call them brood herds where you have the cows, the mamas, and the babies.

So, we're very dependent on that and -- but our small towns seem to be moving along. We didn't see a lot of downturn in COVID other

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than food service. Prices for crops like anhydrous fertilizer skyrocketed this year. It was tremendous.

On the other side, if they held grain over and sold grain this fall, excuse me, this spring, it was probably the best prices they've ever seen in their lives, probably the best prices I've ever seen in my life.

But you put the two together and it's still the same margin for them probably as it was when grain costs were lower and fertilizer prices were lower.

So, most of them by this point had had real estate either close to paid off or paid off. Some of them, it gives them a comfort level. We have been able to retain the more seasoned farmers, and so it -- I think that speaks well to how their ability to transition through.

In my experience, a farmer is very resilient. I always think about those, as little kids, those punching bags where they topple over

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and they come right back up. That's kind of like what farmers are.

Most of them that -- first of all, how they're independently minded and they can figure out a way to keep things going. Maybe they switch up their farming, their plan. Maybe they do something a little bit different. Maybe they step away from something.

Now, I kind of speak that from personal because my husband and I own a farm. We raise cattle, and so hay this summer has been quite something that -- it's been so dry in Missouri.

I mean, we're right on the borderline of drought compared to having enough rain, so the price of hay is probably going to go up in our area because there is just little to -- there was no -- we only had one harvest. Usually a lot of time, you have a second cutting. There is no second cutting.

So, you know, will that affect cattle

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prices? You know, will people be selling them? Maybe. But for the most part, I think they're kind of have in their minds a built-in rise in interest rates, so I think we'll be really good on -- when you think about operating notes coming up for the new year.

Grain prices are still high, so we should, they should come through it okay, and so again, we're trying to make sure we're monitoring that.

We are doing some rate shocking on some of our -- I don't know that we really have marginal credits, but the ones that we could potentially see a little bit of the interest rates going up affect their payments.

However, a lot of our, new loans that we've got, they haven't had time to cycle through a rising interest rate because, I mean, we adjust the rate every one, two years. Well, it's just been this year that they've not seen that change in rates.

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We've had so many so fast that they've not quite seen whether it's going to affect their payments coming up next summer or whenever it is. Maybe they had a 24-month ARM or something.

So, we're going to pay a little more attention to that, but right now, we're doing pretty good and we think we've got a pretty good handle on those that we need to keep an eye on.

MEMBER MAUST: Good morning, Trey Moss with Lewis & Clark Bank out in the state of Oregon. We've got a population of around 4.5 million, so it might be a microcosm of the U.S., but the two headline issues that we're dealing with currently are persistent inflation and a very tight labor market.

On the inflation side, we still are seeing consumer spending that's very, very strong. I think that's overhang from the fiscal stimulus as well as very strong wage growth.

We saw statewide average wages increase 19 percent from pre-pandemic to today,

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which is a pretty big jump, and that was real wage growth up until this past year. So, from that pre-pandemic to today, that outpaced inflation by about 5.5 percent, so definite real wage growth.

However, over the last year, it was actually a negative 1.5 percent, so inflation outpaced wage growth during the past year, and so that's something we're certainly looking at and the impact of willingness to spend.

I think there is still a fair amount, because we're seeing consumer spending continue, so there's a fair amount of savings still in people's accounts and/or people are still use to spending.

And I think until there's that constraint of what's left in the savings accounts as well as availability of credit, because we've seen an increase in consumer credit statewide, once that kind of runs out, I think we'll see that impact there.

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On the labor market side, interestingly, layoffs in Oregon were at their lowest levels ever. 2018 was the last time that it was this low. And while the number of job openings that are out there in the state has fallen, they still outpace the amount of unemployed Oregonians by a factor of 1.6, so that's 1.6 jobs or job openings for every unemployed individual.

And part of that, we might see in an earlier chart that the state has now come close to recovering all of the pre-pandemic jobs in terms of total employment. The labor force participation rate is considerably less than it was prior to the pandemic, and so I think there's just a structural change there.

The last thing I wanted to touch on was housing affordability. The knock-on effects of fiscal tightening, I think, has really had an impact I know on capital markets, which it should, but it's also had an impact on consumers,

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and unfortunately, that's one of those things that occurs every time rates elevate.

It becomes more costly for everybody to do anything, and so housing is one of those. We're trying to address the availability and affordability of housing, and at the same time, it's now almost twice as expensive to carry that mortgage.

It makes it very difficult to achieve home ownership, and so what we're seeing is the higher end of the market is pretty much phased out in terms of affordability and there's a lot of competition now for lower-priced homes and the rental market.

And unfortunately, in Oregon, we had a lot of inbound migration that's exacerbating this and our housing stock is estimated to be about 111,000 units short of demand, and so that just makes it very difficult, I think, for most people.

MS. SCHMIDT: Anyone else? This might

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be a good time to switch to our next topic on slide six. All right, thank you.

Today's interest rate risk and liquidity risk scenario has really evolved since the pandemic. You're all aware and we've been talking about how banks have been flush with deposits since the beginning of the pandemic where, you know, we had all of the economic stimulus.

Consumers and businesses reduced their spending. We talked about agriculture. Farmers had good years. They were building working capital. So, we've really seen steady deposit growth at banks over the past few years as you can see in this chart.

In fact, it was just last quarter, second quarter of 2022, that deposits in the aggregate across the industry declined for the first time in four years. So, and even then, a little over half of all the banks, 51 percent of them, still reported higher deposit balances than

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the previous quarter.

And the community bank population that you're, you know, that you're working in, in the aggregate continued to report deposit growth even last quarter, albeit very small, just half a percent. So, we're still looking at record levels of deposits.

And if you move to slide six, or seven, you can see that high deposit growth combined with slow demand since the pandemic has resulted in significant liquid asset growth at banks, primarily securities, and that's the gold bar in this chart.

So, banks have a lot of -- have built their securities portfolio, and in the slow interest rate environment, they're searching for higher yields, and in doing so, they've extended the maturities of those securities.

Then along comes 2022. The Fed starts raising interest rates to combat inflation and fixed-rate assets, including bonds, have declined

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in value.

So, we saw many banks reporting significant net unrealized losses in their long duration bond portfolios in both the first and second quarters of 2022, and we're poised to see that again in third quarter. In fact, looking at early call report filers through yesterday, 96 or 97 percent of banks are reporting net unrealized losses.

And, of course, this position, you know, it can reduce on balance sheet liquidity, contingent liquidity. It reduces tangible equity. It restrains future earnings. So, this is something that we're really watching.

The FDIC, all of the regions hold regional risk committee meetings in the spring and the fall, and interest rate risk was a high-risk topic for five of our six regions. So, it's something that we're really mindful of right now.

I think the big issue, and I talked to some of you last night, is that this environment,

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this inflation that we haven't seen for 40 years and combined with interest rates actually rising, we've been in such a low for long environment, we have both bankers and examiners that are new to this scenario, right?

So, that's something that we're really mindful of, like I said, and we're addressing interest rate risk and liquidity risk exposure through our existing offsite review programs. Our case managers are calling on more banks talking about these issues.

We have an interest rate risk and liquidity monitoring tools and programs that we continue to use, and our Washington office has held calls with examiners and we're developing more training.

So, that was a very high level and short version of interest rate risk, so I'd like to open it up and hear -- and I heard some great stories last night, so I'm hoping that some of you will share some of those today.

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MEMBER BOCK: We heard part of that conversation last night. From pre-COVID to where we are today, we went through just phenomenal deposit growth and it was literally all across the board.

What we are experiencing right now in a pretty big way is I'm going to say the commercial and consumer world of deposits is starting to decline, and we're starting to see that somewhat in a rapid manner, but at the time same, we still are seeing an inflow of government deposits from multiple different sources.

You know, we talked about some of the stimulus programs that have been discontinued. They may not be in the headlines anymore, but the funds from those programs continue to hit the system.

And I think in visiting with some of our municipal governments and some of those other types of agencies, they expect funds to keep coming into the system probably through a lot of

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2023 until we actually get to the end of what's being fed into the system liquidity-wise for those folks.

So, we're seeing a mixed bag, but we also, in those municipalities, the funds come with some caveats, and the caveat is these funds are meant to be used for X, Y, or Z.

They won't sit on those funds forever, and so over the course of the next 18 to 24 months, we are expecting that group of deposits also to start heading down. It's just a matter of how fast they get those projects done.

But for a time period, yeah, there's multiple grants. There's multiple programs. The funding is still coming for a couple of more years before it actually is going to dry up in the system.

MS. SCHMIDT: That's a very good point and I talked to Mike last night. I told him we monitor concentrations, asset concentrations, deposit concentrations.

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And, you know, it's been surprising over the last year. Municipal concentrations have been what we -- have been risen to the, you know, risen to the top in all of our trend analysis. So, others? Yeah, we talked about --

MEMBER MJARTAN: We covered some of those issues, so let me just, first of all, thank the Acting Chairman for giving us this time, and listening, and the rest of the team.

So, I'm going to put my comments in the context of our bank, which is a Black-owned, minority-owned, CDFI bank based in South Carolina. We're about \$400 million in assets. So, we're a little bit unique.

So, everything I share is not necessarily countering what's been said, but it's through a unique lens of a bank that intentionally serves to close the gaps that exist and really channel opportunities, and hope, and capital to underserved people and places, so that's kind of my lens and what I focus on every

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day.

So, our banks are -- I would say the biggest risks we have today is really of interest rate risk and liquidity risk. Those are the two that are facing us very clearly.

We are starting to be concerned somewhat about the credit risk because we're over-represented in the communities that are disproportionately impacted by systemic disparities but also by inflation.

So, if there are higher costs, those are going to be translated much more so in our credit quality than probably pure banks. Now, perversely, our asset quality is the best it's been since the bank was founded. So, we're not seeing that yet, but what we are starting to see is significant rate pressures.

So, banks like ours, and my friend and Chairman of the National Bankers Association, Robert, and I talk about this a lot, is, you know, our banks are banking communities that are

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capital starved. So, our ability to generate liquidity in deposits is subpar at best.

Now, we have a 52 percent liquidity ratio today, although as of my last loan committee yesterday, it's now 70 percent, right, so we're starting to burn through that liquidity. Simultaneously, we see a run off.

Thankfully, that run off has been compensated by investments and support from some of the larger institutions that have stepped into this gap and have allowed us to do that.

So, I am very concerned about the short-term future in terms of liquidity and us meeting the needs of our communities because that liquidity is running off, and also repricing for some of us.

We generate deposits from larger institutional investors, CRA-motivated investors, public entities. Those are all repricing gradually now. Thankfully, our asset yields have repriced faster, so our NIM has

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increased, but I think that song is going to stop pretty soon.

Long term, we are very concerned about, you know, what is the future of institutions that are smaller like ours that are in this environment? How do we meet the needs of our communities with this shift of liquidity to larger institutions?

And unless that shift of these deposits is somewhat reversed, maybe through policy, and practice, and with CRA reform or whatever, into mission-driven institutions that are serving capital-starved communities, I think we could see a pretty challenging liquidity environment for smaller banks and also in terms of our interest income.

MS. SCHMIDT: Others who would like to talk about some of these interest rate pressures and what you're expecting about your deposit base?

MEMBER REIGELSBERGER: I might say

something. Our liquidity is very good. We -- after we saw the Fed starting increasing rates, we kind of took the bull by the horns. Now, I'm a \$142 million family-owned bank, so that's our shareholders as one family. They are very involved in our bank.

So when early on like in March of April when we got to -- basically, reading the writing on the wall how much increases the Fed is going to take, they immediately redumped a bunch of long term mortgage backed securities. We took a loss, yes. It was strategic. We reinvesting in some treasuries now that are a little higher and trying to dollar-cost average that. But I think I think we were -- I feel like a big advantage with a family-owned bank.

Our shareholders knew the decision that management and them worked together to figure out if this is the kind of loss we wanted to create up front because, you know, it's right out there. You can't hide it. It's there. So

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that's what we did and we're trying to recycle, kind of re-strategize any securities that we're purchasing right now.

Other thing that we're kind of dealing with too is our loan to deposit ratio is not real high. Now we've seen growth in our loans about 30 percent, but that's a far cry from where our deposits have increased, but we do have in our markets, we do have a couple of more community banks that have a much higher loan to deposit ratio. So guess what they're doing? They've just jacked up their rates a lot.

So we haven't really moved ours at all and trying to build in a little bit of that net interest margin. Probably not, we're not going to get in that rate war with them. If we do lose a few deposits, evidently, they're a little bit more hot money is what we used to call it back years ago. We might come back, but we're trying to be smart about it. You know, this is looking at our bank, where we're at now.

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Granted, if we start seeing much runoff, we want to be sure we're marketing and repricing appropriately. But that's kind of where we're at is some of our local banks, have, looking for that money so they're upping their interest rates and we're just kind of like -- oh, going to wait and see how that plays out. We're not going to play that game.

MEMBER WHARTON: My name is P.J. Wharton, President of Yampa Valley Bank in Steamboat Springs, Colorado and Craig, Colorado. We are a little bit of a unique financial institution, two branches, but we're in the mountains in a resort community and the best way I can describe that is New Year's Eve and Fourth of July we're 25,000 to 30,000 people and then March and October we're about 12,500 people, so it actually literally doubles a couple times of the year. And this time of year, there's a lot of moose and bear and a number of us walking around town.

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I want to make a couple of comments back to inflation and a big surprise to all of us, but affordable housing has been absolutely exacerbated by inflation. In our communities, we're seeing rental rates of \$1200 per room, so many of our employees are doubling and tripling up with friends and people they don't like to make it work.

Many of our hourly employees are making \$20 to \$30 per hour, but are being forced, as I said, to have roommates and commuting 25 to 44 miles. And again, those of you guys who have been in the mountains before, winter driving can be pretty difficult and dangerous. So obviously, it's all about affordable housing. So that's translated for us again, probably similar to you, shortages of customer-facing employees are most important folks, frankly. So that has turned into complaints from our customer base. Nobody answers the phone. The reason I bank with you is that personal service and being able to talk to

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Anna Maria or P.J. when you guys answer the phone personally.

So we need to do -- we're doing more to keep them. Just as an example, the median home listing in Steamboat Springs last month was \$1.6 million. So that's kind of where we are at the moment. There are six active listings under \$1 million in the city of Steamboat Springs.

We've incorporated from an inflation perspective just this year \$1,000 signing bonus after 60 days. And this is for our tellers and customer service representatives. We've raised our starting rate from \$20 now to \$21 this week per hour. We've added production bonuses to tellers for our highest transactions with accuracy knockouts, so that's a quarterly bonus that we're paying. We've added notary bonuses to encourage customer service. We probably do more notaries than any other bank in town.

We've added new account bonuses for every account that's opened. We just paid a \$500

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stay bonus last week. We went from seven tellers in Steamboat to three over the course of six weeks, people moving out of state. And during everything, that is a thank you to keep them.

Going back to Trey's comment about year over year SG&A, our merit budget for 2021 was a 6 percent increase. Year over year our SG&A is up 15 percent due to adds to staff. In health insurance, we're all experiencing that and then the 6 percent pay increase.

Kind of alternate from a lot of the comments here, our near term compression, our margin or NIM has actually decreased because we have seen kind of a slow increase in our interest rates on our loan side because so many of our folks have locked in on fixed rates and then we've proactively went after the deposit market really more as a loyalty and as a statement to our community on interest rates. So we think our margin is going to improve, but the volatility has been so fast and so steep we actually need

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some time to catch up and that's probably one of my greatest concerns is we were joking about the yield curve -- I'd never heard this before -- as a tip. And my greatest concern is it goes up super-fast, comes right back down, and we all know what happens. Our customers come in, I need to re-price my loan or I'm going to leave. So that's one of our greatest concerns.

Finally, just deposits, we've been proactive. I'm hearing from a lot of my peer group in the metro Denver area of liquidity leaving, but we actually had one month deposit growth in our market of 4 percent, 3 months of 6 percent and year over year, we're up \$73 million, 16 percent. So it's been a little bit unique in our markets.

MEMBER JAMES: Robert James, Carver State Bank, Savannah, Georgia. We are a 95-year-old, African American-owned MDI and CDFI certified institution. And what that means is that we have a commitment to make at least 60

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percent of our loans on a year over year basis in low-income communities around our market.

And so we are experiencing historic levels of capital and liquidity which is good going into this environment. I do echo my colleague Dom's points about concern about making sure that we're going to be able to access liquidity going forward, particularly as we're in this kind of growth mode.

Historically, minority-owned banks usually at every kind of major negative economic inflection point in the history of the United States, you lose large numbers of minority-owned and particularly Black-owned banks. So at the Great Recession, we lost over half the Black-owned banks. And that was because there wasn't enough capital in the system. There was a lot of pressure on the assets that we were lending against. In terms of having a market to market, there's a lot of systemic and reasons that we can spend the entire day talking about that caused a

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lot of those failures.

What's different in this environment is that in the last two years, many of our institutions have accessed Tier 1 capital in a way that we never have in the history of the United States. And so just to give you a sense of scale for that, our bank in 2019, I think we were at just around \$50 million in total assets. Around 10, 12 percent Tier 1 capital, our capital has increased 400 percent. Tier 1 permanent capital has increased 400 percent in the last two years. So that's fantastic. And that gives us the ability to look forward into this really uncertain environment with some confidence that we can make some critical investments and build.

But P.J. made a great point. It's hard to hire people. We have more capital, more locations. We just completed an acquisition. We bought another institution in Alabama, so our first acquisition in 95 years, but we can't find people. And so we have fewer people now than we

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did when we were \$25 or \$30 or \$40 million in total assets. So it puts a lot of pressure on the staff.

We are experiencing, in the short term, we are experiencing strong net interest margins. Our income is up because we were able to take excess cash and invest in short-term Treasuries and so our income is up. But we do have concerns about the inflationary pressures on our customer base that are just not going to be able to afford to continue to keep up their payments as we continue to adjust their pricing up to track prime or whatever index we're pricing their loans against.

And we're particularly concerned about housing and small business lending going into the next couple of years because I do agree that in a recession when the big banks pull back, there's going to be opportunities for us to step in. In our communities on the small business side, we're going to have to use whatever

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available credit enhancements we can find in order to continue to make loans and so we're finding that even for -- I was talking yesterday about a million dollar small business loan that we've been working on for almost a year and we've got every available credit enhancement tool, every state program, ever federal program that we can use to try to stack capital for this minority-owned business and we're going to have to kind of continue to turn over every rock in order to be able to continue to move capital out into the community, particularly in this inflationary environment and do it in a way that people can afford to make the payments.

The last point that I'll make is we are extremely concerned about housing costs in our market. You know, Savannah, Georgia, but also Atlanta, now Birmingham, places that we are operating, housing cost was high before, and now with rates raising, it's just putting affordability both from a rental and a purchase

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standpoint just out of reach for in particular, a lot of the working class businesses and consumers that we serve in terms of being able to afford to build and afford to then be able to sell it or rent it.

So all of those are issues that we're continuing to monitor, but at least we're in a good capital position going into it, so that we hopefully will be able to invest and then be able to come back out of it stronger for the community. Thank you.

MEMBER CAMPBELL: I'm Troy Campbell with Altoona First Savings Bank in Altoona, Pennsylvania.

We are a mutual savings bank, prior S&L. We do a lot of one-to-four family lending. We focus very heavily on small business, locally-owned business. And we've funded those over the last 96 years through deposits, local deposits. And we use the term hot deposits as well, but we found that with the low-rate environment, we have

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an elderly population so they struggled. They struggled to afford the prescriptions and everything else. And now with inflation, we're seeing people who are loyal customers to the bank are shifting deposits.

We have a local broker, a national broker who is actually offering 4.35 percent for a 12-month CD. And so we've seen a very rapid run on deposits because of -- and the broker is actually going -- it's minimum deposit of \$1,000 and it used to be \$50,000 or \$100,000, but they're actually coming right after our customers.

So one of the concerns that we have is we've seen a rapid decrease in deposits is looking at the borrowing window of FHLB and the issue with FHFA and the definition and the potential for limited borrowing capacity. As a community bank, FHLB is our primary contingency liquidity plan. And, so that's a real concern and I know that FDIC can't really address that. That's something that FHFA has to address, but

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it's probably the one thing that keeps me up at night and I'd love to know the three percent of banks that don't have net unrealized losses on their portfolio.

That's pretty amazing. I'm thinking they don't have a portfolio. But that's kind of where we are as a community bank. And as we look forward, we want to continue serving our customers and so we've actually limited our participation levels with other community banks in our market where typically we're sharing on loans, but just from a liquidity planning perspective, we're not able to really partner with them because we want to make sure we have the liquidity in place to support our direct customers.

MEMBER LOWRY: I'm Bruce Lowry with Ireland Bank in Malad City, Idaho. I would echo those comments. I think that's our number one short-term concern is the strain or potential strain on liquidity. It's an accounting problem

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that can turn into a real problem. So the tangible equity has come to the surface of something that we really look at closely now. We're looking at some different strategies with our portfolio to try to minimize going forward what can happen with unrealized loss.

For us, it's about a two-year window. If we can get through the next two years without any trouble liquidity-wise, then we've got a gob of it, you know, coming off the books. So that's the biggest concern, utilize the home loan link to supplement short term liquidity needs as probably everyone here does and if that access were limited or constrained, that's a big concern.

MEMBER NARVAEZ: I'm Gilbert Narvaez, Jr. I'm president of Falcon Bank and we're located in Laredo, Texas, just south of San Antonio. We're in a very robust economic activity out there with the international trade business. We've seen our liquidity levels

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actually continue to increase and get stronger. And consequently, we're also -- we've also -- we're not one of the three percent that don't have any type of unrealized losses in our portfolio. So we did invest in 2021 when you could buy mortgage backs at 1.5 and now those are severely under water right now.

What we're doing now is trying to with the additional cash flows coming in from the investors' portfolio, we're reinvesting them into the existing rates in the environment right now which are quite attractive and we hope that those will average in and when we hit that tipi going down, we'll start realizing or gaining some of our unrealized losses back into some gains.

The other thing, too, is our -- because our liquidity is so strong, there's been a level of competitors actually offering higher rates, so we've seen a little bit of deposits run off and we're not quite ready to match those high 3.5, 4 percent rates that are being offered in

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some of our markets. So we're kind of in a very good position at this point fortunately. Thank you.

MEMBER MAUST: I'd like to add just one final comment on -- as we're going around the table, it feels like downside risk and there's a tremendous amount when we think about the volatility, the uncertainty that we're facing over a hopefully short period of time. But let's assume it's protracted a little bit.

One of the things or activities or exercises that I know all of us have done over the past few years that have felt academic in nature has now become real and that is the scenario analysis with stress testing and various other scenarios that we're running on liquidity and interest rate risk. And I have to say for us it's been one of those environments that we didn't want to face, but it's become a great catalyst for the Board to be highly engaged in a much broader array of scenarios for us to

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evaluate and determine what are those proactive measures we're going to take strategically and so it's actually to reengage those conversations and highlight the importance of those.

I do remember years ago when banks were -- I don't mean just during the pandemic, but prior to that, where you used to have a liquidity and they felt that was enough and that's not now. So we really have to be proactively focused. And at least, I want to put a bit of a silver lining, because I think all of us are doing that. We just are very much aware of the risks that are out there.

MS. SCHMIDT: Yes, I think that's a good summary. We're starting from a pretty strong position and we'll probably get into this, consumers have been in a strong position, but downside risk is probably a good summary.

So maybe let's move and start talking about some of the real estate and consumer lending risks.

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MS. OLESIUK: Great. So we'll transition to the last section of the prepared remarks and then kind of open it up for any other topics that you want to discuss.

So I'll be talking about -- well, the risk review report itself covered many aspects of credit risk. We'll be focusing on just a couple of those today that I think we're watching the most closely starting out with commercial real estate.

So on this chart, we're showing the net absorption as a share of inventory for four major property types that we follow. So this is sort of an indicator of demand for each of these property types.

As you can see, the red line at the bottom of the chart representing the office market, that's where we've had the most concerns. And these are national data. I know there's different variations depending on the most urban markets and other markets around the country, but

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nationally we saw a net decline in absorption relative to inventory both in 2020 and 2021 as corporations, companies are sort of reconsidering how much office space do we need and that's showing up as a decline in demand.

We also saw a slight dip in retail in 2020, but that has since recovered. And then on the other side of the spectrum, very strong demand in the industrial and multi-family segments, industrial, of course, being driven by the logistics and online shopping that emerged during the pandemic and facilities, warehouses to support that activity. And then I think some of the comments on affordability challenges have driven the multi-family demand. So kind of a mixed bag in terms of market conditions for commercial real estate. So I'd be interested in any comments you have there.

On the commercial real estate as far as the size of the portfolio, this chart shows banks in aggregate loans outstanding to

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commercial real estate in the four different categories that we look at, so we've seen a continued increase in loans outstanding. Of course, these numbers are shown in dollar volume, but if we look at concentration levels, I think those are down relative to the Great Recession, other peak times in history.

Other differences here, the red segment, the multi-family outstanding loans have been a source of growth. The darkest blue category at the bottom there construction lending still is important, but relatively speaking as a share of the total portfolio compared to 2008, ADC lending is much, much smaller. So that's probably a good thing as far as risk goes.

Moving on to the residential story, residential real estate. So this chart looks at the year over year house price index for the four major geographic areas of the country. So the main take away, probably no surprise to anyone here, we're starting to see a peak and some

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decline in the pace of growth for the house price index across most of the categories -- most of the geographic areas.

We don't do our own forecast, but we use a lot of forecast information from the industry and looking ahead to what's expected for home prices, the forecasts are really kind of all across the board. I think the most common forecast that I've seen looking out at about a year or so shows this pace of home price appreciation decelerating, but not falling negative, at least for the major categories. If you look at individual markets, I think it's a very different story, but nationally, the pace of home price appreciation falling almost to zero, but not dipping negative is the latest forecast I saw.

One of the major metrics that we look at to gauge the strength of the housing market is shown on the dark blue line here which shows the supply of homes for sale based on the pace of

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home sales. And the major take away here at least through the end of 2021, there was very little inventory available for sale. The supply of homes for sale had dropped down to, as you can see, about two months of inventory. Over the last six months or so it's climbed to about three to four months, but still not yet back to that level of six months which is considered to be sort of an indicator of a balanced market.

So I think this is something that's keeping those house prices somewhat more stable than one might think when we look at mortgage rates because there's just limited inventory out there for sale.

Looking at the credit quality on the residential side of things, and this is using data from the call reports that we get on -- so this is bank held mortgage loans. The main take away here is mortgage credit is very strong now. So the shaded areas of these bars represent the share of banks in each of these buckets of past

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due rate for the mortgage credit. So looking at the 2021 bar, we see about half of banks have a past due rate between zero and one percent. Compare that to just a couple of years ago, pre-pandemic, we're far better and certainly far better than 2010, 2011. So I think banks are entering this period of potential stress in a very strong position relative to the mortgage market.

And lastly, we had a section looking at the consumer sector. This is an area, as I've already heard this morning, that we're looking at as far as potential stress for consumers. So what's shown here on this chart is various sources of consumer income, so obviously, during the pandemic that gold line which represents the government transfers, consumers really benefitted from how much money they were getting from government transfers. Those have essentially all ended and so I think now consumers are being faced with varying levels of

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stress from lower income consumers that these types of transfers really mattered a lot, maybe seeing some potential stress whereas higher income consumers maybe not feeling it quite as much.

The final slide looks at non-current loan rates for various consumer portfolios, so essentially the story here is the consumer portfolios at our banks as reported by the call report information looks fairly strong. You can see a slight uptick in that gold line representing the credit card non-current rates. And we saw the same thing we reported in the second quarter, quarterly banking profile that early delinquencies, past due loan rates were starting to tick up for consumer loans. So potentially indicators of some stress, but overall, relative to even pre-pandemic, banks looked to be in a strong position on the consumer side.

So I will pause there and again turn

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it over to you, anything else that you'd like to share on your outlook for loan growth and credit quality, underwriting standards, anything else on the credit side.

MEMBER CAPOBIANCO: I'm Tony Capobianco. I'm from American Community Bank in Glen Cove, New York.

I'll start this one off. The lion's share of the assets on our balance sheet is great. So we had a concentration of about 300 percent, so we're right within the guidelines, but if you add in owner-occupied commercial real estate which is by definition not in the concentration ratio, we're above 400 percent. But we constantly do stress testing on our portfolio. Even prior to the pandemic and we cut it up every which way by geography, by industry, by demographics.

We're not a big bank. We're \$275 million. So we're small enough now to keep up with all of our borrowers and all of our loans

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and we pretty much know all the relationships in the portfolio.

I don't think that we'll have an issue with credit quality. Their rates are fixed, so many of their loans are priced in a favorable environment in the low fours, sometimes under four. And they have that rate for five years, they're five-year ARMs whereas on the funding side, the rates re-price daily sometimes, other than CDs, obviously. So we all have that mismatch on our balance sheets for the most part.

The other thing is that many of our core account relationships are real estate businessmen and they use leverage and they refinance consistently, but I don't think that business is going to be -- will be continuing in the next year or so with the rates the way they are.

So we anticipate a decline in the loan growth. Don't think we'll have many issues in our credit quality. We haven't changed our

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underwriting standards due to the inflation or the rising interest rates because even before the pandemic we were very conservative and we stressed the rates on our underwriting.

When the pandemic happened, we were even more conservative and we haven't changed since then. So I think that hopefully, knock on wood, that we will have no issues with credit quality.

And I guess the other trends or concerns that I'd like to highlight are kind of echoing what everyone else says and knows is that the -- with inflation and with rising interest rates on the funding side, the compression on net interest margins will probably have an impact going forward, but we're well capitalized and well positioned enough to continue to serve our communities and that's our mission. That's all of our missions. And it's very rewarding when we're able to do that and I hope that we can continue to do that particularly with the customers that

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we serve which are mainly small business customers.

MS. OLESIUK: Thank you.

MEMBER PILARSKI: Shane Pilarski, I'm from Northern Indiana. We're about a \$400 million bank. And prior to this year I would have said we're primarily an ag bank, but, for the first time since I've been at the bank, our CRE has outpaced our ag loans.

For a couple of reasons, primarily, as some people have already talked about, farmers have had really good couple years. And with the rising rates, they've looked at, I don't want to be sitting on this cash, let's pay down my lines of credit. So our ag loans have dropped.

Fortunately we've been able to pick up some CRE, primarily in participations. We're still sitting under 50 percent loan to deposit ratio, we've got a really good, stable core deposit base and we would love to loan more, especially in ag where we have our niche. But

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we've got farm credit all around us and that makes it extremely difficult, so that's probably a big concern to us.

We have not adjusted our underwriting standards, we remain conservative. And so it'll be interesting, as we look to see what happens in the future, how farm credit continues to kind of play into what happens with our loan growth. Thank you.

MS. OLESIUK: Thanks.

MEMBER WEST: I'm Andrew West, president of Eagle Bank in Polson, Montana. We are one of the 18 tribally-owned banks in the country.

And just with regard to the outlook for loan growth, I'm not super optimistic, with the increase in interest rates. I do think credit quality will maintain, like Tony, we shock test the heck out of our -- I mean, everything that we underwrite gets a shock test for declining cash flow and increasing interest rates. So I feel

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okay about that, but I see loan demand dropping off, particularly in mortgages but also in commercial real estate.

But one thing that I hear a lot, which is interesting, is with regard to the changing of the underwriting standards. In Lake County, where I live, we've seen in the last few years a 54 percent increase in real estate values. We've done more home equity lines, people are tapping that like crazy, and a lot of construction and development.

So we have changed our underwriting guidelines, we went from 80 percent loan to value on home equity lines to 70 percent max loan value per policy. And then also, with construction loans, 75 percent loan to value. Because I believe there's going to be a precipitous decline in real estate values in the next couple years, and I don't want to be upside down on some of these houses.

And it greatly concerns me how -- we

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did seven HELOCs, maybe, in 2019, we did 13 last quarter, it's nuts. So, concerning to me, wanting to keep the bank safe we've just lowered our LTV and we've been pretty consistent on not making policy exceptions with regard to debt-to-income.

But what concerns me the most, at least for where I live, is a massive influx of out-of-staters moving in and driving real estate values to a point where the people who live where I live cannot afford to buy a home anymore. And they're still -- even with the rising interest rates, we're seeing a ton of cash-buyers coming in.

So construction remains good but the locals are getting squeezed out, and I'm not sure where they're going to go. We are seeing an increase in some multi-family, but it's challenging where I live to get multi-family built. So, anyway, that's it.

MS. OLESIUK: Yeah, I think you make

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a good point, that markets that have seen this rapid rise over the last couple of years in home prices, you know, Montana, Idaho, those are some of the markets that -- at least the forecasts show that, you know, they had such a rapid rise they might see weaker houses prices.

MEMBER OSTERBUHR: I'm Arlen Osterbuhr, I'm with Minden Exchange Bank in Minden, Nebraska. The Minden Exchange Bank is about \$180 million bank.

We've had escalated liquidity, just due to a lot of stimulus money and about three years back-to-back of really good agriculture years, to the point where our loan to deposit ratio had gotten down to 50 percent or less.

And what I'm seeing now with our loan growth is it's continuing to grow this year, business and industry is buying more inventory and building up for -- as we've seen a shortage of product for their companies to grow and continue on. And their agriculture costs have

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escalated, the cost of food, fuel, transportation cost has continued to grow as well.

And right now it's harvest time and commodity prices are good, we're seeing money coming in. Although the costs were high, harvest costs were high this year, and it's now time to buy product for 2023's crop year.

And so we've run a program for investing in the 2023 input loans, and so we've discounted interest rate for them to purchase product such as seed, and they generally buy for a percentage less by buying early but also locking in on a lower interest rate on a loan. We generally tie that to the New York Prime, and that's helped us with having loan growth.

We're also having a lot of stress testing going on, we're making sure credits are good, our liquidity has reduced and we have adequate loan value ratios and ratio analysis. Our loan committee meets twice a week and we're pretty transparent in our loan committee, we try

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to discuss every loan that's over \$100,000. And lines of credit are very popular where we're at, for operating expenses for both business industry, and also agriculture.

As far as underwriting standards, we have not changed those, we've been pretty strict on making sure that our underwriting standards are strong, and we stand by those.

We are a locally owned bank as well and a family-owned bank, and so we've tried to stand pretty firm in all of those rates and all of those standards for ratio analysis that we set.

I anticipate that we'll continue to see loan growth, we also are seeing a housing increase in construction. We have three housing developments going on in our community right now, we just finished up a 50 housing unit that, all the homes were sold -- prior to interest rates going up, of course -- were sold before they were finished.

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We have another 40-home development going on and we anticipate a little slower growth there, we've also increased the cost of the lots due to the infrastructure cost. And of course interest rates will be higher, so we anticipate that'll be a slower growing area of the town, of our community.

But I anticipate that loan growth will continue, it's just going to be a little slower, and we have to be very prudent in the loans we make. Thank you.

MEMBER KITNER: Hi, I'm Cindy Kitner. I am with Jefferson Security Bank in Shepherdstown, West Virginia -- for proximity, we're about 80 miles from where we're sitting today. With us, we are the oldest operating corporation in the state of West Virginia, so very focused on our local community, we've been there for a 153 years.

In addition to that, with our proximity to the northern Virginia market and

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with some of the connections that our lenders have, it's not uncommon for us to look at some smaller construction projects in the northern Virginia area, even though our focus is more locally.

I would say I share in a lot of the concerns that we've heard here today, I think the inflation and the rising interest rates, we have a lot of concern with how are our customers going to handle as their payments adjust, it's a big concern.

In addition to that, from a deposit and loan growth area, from deposits we really haven't seen the decline that I know a lot of others have. I think in part, during the pandemic, and really just with our proximity, it's not uncommon for us to have a lot of commuters that commute into the northern Virginia area. And when everyone went virtual, it was certainly advantageous and interesting to come further out into some of our markets.

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So we've continued to see the deposit growth, as well as strong loan growth. We are a heavy real estate lender, so we certainly share in Andrew's concerns with the value of real estate, going forward.

Liquidity is something that we've had a lower loan to deposit ratio, we had worked really hard to improve that before the pandemic, and saw the effects that everyone else saw through that time. So we're closely watching our liquidity now, as we've seen our loan growth outpace our deposit growth through recent times. Do we think that that loan growth will decline? We do.

And as far as underwriting standards, we haven't officially changed anything today but we're looking very closely, and we're talking a lot more about stress testing in our loan committees and in our board. We've done -- I feel like we do very thorough analysis on our loans, and we have and we do stress test a lot

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within the presentations that we prepare.

But the question, I think, for me and for others, what's enough in this market, how far can we go, how far can we stretch our thoughts to really think about how bad this could be, and how we can prepare ourselves and our borrowers, and our customers, for those potentially long-term rising rate environments?

And I agree with the comment that was made earlier that, if we do see the decline in rates then the amount of people coming in the door looking for those loans to be re-written is going to be pretty quick, as we've seen before as well. So I think those summarize some of the concerns that we have.

And lastly, I would just comment that, like so many others, we have a lot of competition in our market with increased deposit rates. We have not risen rates at this point on the deposit side, we are mindful, we consider specials and look at what is the right fit for us. But with

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the liquidity position that we're in today, that's just not a step that we've taken quite yet. Thank you.

MEMBER MCCURRY: Hi, my name's Neil McCurry. I'm in Sarasota, Florida, which is southwest Florida, so all of my comments about what's happening with credit risk really are before the hurricane that we just dealt with. Because we don't know how that's still going to play out, it was a devastating situation that happened and to our communities and the whole southwest part of the state.

But prior to that, you know, we talked a lot about credit risk, and in Florida and in our community, we've really -- everyone's done well, the banks have done well, the businesses have done well. So it's been a great time to be in any type of business in Florida, but we've tried to be aware of what darker clouds are out there as well.

And certainly what's happened with the

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interest rates like we've talked about, and housing problems as well. So we've looked to really challenge ourselves about how do we continue to be a source for our community and the businesses, but at the same time prudently navigate through the economic climates that are ahead of us.

We, as was said by others, have always done stress tests, sensitivity analysis. One of the things that we've started doing is looking at the businesses because -- again, all of our clients are doing well -- but we look at the type of business they're in.

If you're in the air conditioning business in Florida, if someone's air conditioning breaks, they get it fixed. So those are ones that I think will continue to be in demand.

What about ones that are more discretionary, what if you're in the boating business or you serve something with boating?

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And those are the type of things that you might see a softening, a quicker softening, so we're looking at our clients as well, and what type of products and services do they provide.

We're also talking to our clients about what type of concerns they're having about supply chains, getting whatever materials, products they need to continue to be successful.

And also their staffing, you know, we're having staffing challenges. I heard about employee cost and challenges to get people, to keep people, and the businesses are as well, and how are they doing it, and what impact it will have on them if they have to continue to raise their labor cost, or if they struggle to get labor as well.

So we're really trying to make sure that we're looking forward as well, we haven't so much changed our loan policy but we're trying to very much adhere to it. If there is a policy exception, well that's always important to

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reflect on. You know, it needs to be really a real reason why are we okay with -- if we believe our policy is correct, why are we okay with a policy exception. So we're really pushing ourselves to question ourselves on those as well.

You know, the trends that are concerning in Florida is housing and mortgage rates, our mortgage production has dropped dramatically. And looking forward as well, is housing costs were high, we're not sure what's going to happen when all of the construction industry is going to be focused on re-building homes that were destroyed.

That will certainly have an impact on cost and ability to get people as well, so what you will have to pay to have a home constructed, which vis-a-vis will translate to existing home sales well. So how will that impact the people in our community?

So there's a lot of unknowns out there and I think, like everybody, I appreciate hearing

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everybody else's comments about how they're thinking about it as well, because it's a really interesting and challenging times that we're navigating right now. Thank you.

(Simultaneous speaking.)

MS. OLESIUK: Thank you.

MEMBER HORVAT: I would just add, as I mentioned earlier, we had a record year this year in terms of our commercial loan originations, we will do over \$400 million this year in originations. A lot of that is in the CRE space throughout New England, but we haven't changed our underwriting standards.

And one of the positive trends that we're seeing is our competition is not changing their standards either, so that's a real benefit. That's something that those of us that were around in the '90s saw some crazy things happening, and it led to some bad results, we're not seeing that right now.

What we are seeing are deals are

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harder to underwrite because of the increasing interest rates, and as a result we're asking borrowers to come up with more money to the table, not changing how we would structure it. So, so far they don't like it but its worked.

We're also seeing something where some of our stronger borrowers have just said, I don't really want to borrow money at seven percent interest and I'm just going to pay cash. So that obviously doesn't help our origination, and those are the borrowers we'd like to have, but it's actually a good sign for the economy as a whole.

So some relatively positive trends, although we're expecting volume to be down about 20 percent next year, that's our prediction.

MEMBER JOHNSON: I had the opportunity to be on a CEO forum with Illinois bankers, just in the last month, and one of the points were about, just kind of like this, what trends are more concerning to you. And one of the questions that I really wanted to hear about and I was

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interested in what you had to say today was, what are you keeping your eye on? What is the next thing that's going to fall? Is it housing?

And so we're hearing some of that but, kind of at the end of this, I hear it's a little bit of everything. It doesn't matter, even if you have a business that's productive, you have air conditioning, they still have to get the workers to come in and do the job to get the revenue to complete the jobs, to get paid.

So I'm just taken back a little, it's just not one particular industry or sector, it's kind of -- this is affecting all of us and we have to keep an eye on everything that we're doing.

MEMBER KITNER: Just a comment on a couple of other things as well. I know I talked with some about staffing, and we talked about staffing from not only having trouble bringing in and finding that staff, but also -- if I look back at our bank, again with the history that

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we've had, there was a point in time that I could easily say, in deposit operations, we had collectively 100 years' worth of experience. And when we look today, collectively we have less than 10 years.

So the amount of time that the management team is spending with training and monitoring, and ensuring that our younger staff -- and not only younger but newer staff, some of them are more seasoned in other businesses, but not specifically to banking. So making sure that they truly understand those regulations, and that we can share some of the hurdles that we've experienced over the years with them, to try to prevent any unseen circumstances is challenging for us.

And then just to your point, again, on construction, one of the things that we've seen is our contractors have just been incredibly busy. And with the combination of the volume that they're taking on, and with the supply chain

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issues, a lot of our construction loans are running a lot longer than what we wish and would hope.

So monitoring those closely, monitoring and analyzing not just the draw schedules, but also doing periodic analysis throughout to make sure that we're not going to run into a problem and not be able to complete the project as the borrower anticipates, or just any other construction issues.

I just wanted to point that out that that's another area that we're spending a tremendous amount of time on, with watching those contractors, making sure that we know them and we know their work in a strong way. But knowing that there's risk there as well.

MEMBER BOCK: I think you make a great point on employee longevity, you know, there's a lot of different things experience fixes.

And I think the other thing in the concern area that I have, because of that young

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staff, the cybersecurity issue gets even higher in my book. Because some many of them get emails, they get all the things that can start the ball in motion for bigger problems.

And when they don't have the experience that some of your staff have had for a lot of years, they're going to be more inclined to make that first mistake that can lead to other concerns and other problems for us.

And I think we've talked about a lot of things today that we are all facing, but I think that is one that could open the door to some big problems really quickly. And the inexperienced staff, as much as you keep training, testing, trying to keep them up to date, when we run literally our monthly tests on staff, it's always the newest people that get tricked on the internal testing.

And it only takes one, you can be good 99 percent of the time, but if it just happens once, and I think that's one of the concerns I

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think is elevating up as our staff gets younger.

And, you know, you got the cyber, and then how many of your staff are 40 years old in the lending department that have never been through an economic cycle before, like we're going through? You know, you can talk about credit standards, policies, etcetera, and sometimes until they've experienced it they don't really believe it.

And I think it's going to be interesting to keep them, I guess, on-task and start talking -- they look at an appraisal, the appraisal looks good, yes but that appraisal was done with a cap rate that was an environment from 12 months ago. Our new environment needs a cap rate of this, and it suddenly impacts the value of the property significantly.

And I think it's the younger staff in multiple areas that are going to create new training challenges for all of us, to keep them up to date as we move forward.

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MEMBER JAMES: To your point about technology risk, Mike. Our institution has got a heightened concern around cyber risk particularly because, not just bringing inexperienced banking staff or employees, but also because in order for us to get work done we're having to, you know, hire people outside of our traditional market.

We're a traditional, very low tech, high touch bank. And we're having to move into being a much more high tech, high touch bank, which means that we've got, you know, in addition to the core team that's in Savannah we now have a handful of employees in the metro Atlanta area. Which means that they're having to remote in, which means that they're having to access systems in ways that our current, you know, our traditional staff is just not really used to.

And so making sure that we have the proper protocols in place from a cyber risk perspective, just to handle remote employees, is

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a big risk. And also an additional cost because we've got to add, you know, we've got to add system controls with our network systems and security provider on top of what we're spending with the core processor, to make sure that we're, you know, maintaining integrity and protecting our customer data and our systems.

And so that's a big concern for us, going forward.

MEMBER MAUST: Just responding to the general discussion question.

I think about the long range prospects for community banks, we have I think a permanent foothold in relationship banking, I think we always will. I think we also need to augment that and really harness those strengths, so the ability to understand our clients, the ability to communicate with them directly to really think about risk on an individual transactional level, as well a portfolio level.

And deploy those in ways that the

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market is currently, and I think in the future, demanding. And that's going to be more digital, it's going to be more integrated into the real economy, so whether that's commercial enterprises or other ways of us integrating banking products and services into.

I think all of those, whether we digitally go out to market or we utilize an integrated approach with the real economy are going to be utilizing third parties. And I think -- now I know we've talked a lot about third party risk management historically, and that's another example of what was probably more academic in discussion, is now real and will be as we move forward.

And I do want to thank the FDIC for a couple years ago issuing the ANPR, that was really helpful for those of us that are really looking at third parties as deployment partners. Whether that's channel partners or it's just using it in our back office, to think through in

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a very detailed level what's needed and what we need to be thinking about, especially at the board level, so we can make sure we understand the risk and feel like we can manage it.

I think that's going to become a much bigger mechanism for us to go to market and really serve our local communities, as well as probably more broadly, a much greater geographic area.

So I'd love to have maybe an opportunity in the future to talk more about that as well. So thank you.

MEMBER MJARTAN: Maybe I could hit on a couple longer term trends that I'm thinking about.

I do think there's a lot of rise in various disruptive technologies out there, that right now are may be just on the outskirts, maybe they're a few years out. I'm not just talking about the cryptocurrencies or the blockchain technologies and all that, but I do think there's a -- the last number that I saw, there's

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significant -- even with the current decline temporarily -- there is a significant shift. A huge chunk of the U.S. economy is now in this shadow crypto-space.

And so, I know that for some of our community banks that rely on core deposits, what are they going to do? Combine that with an aging customer base, and so banking customers, maybe there is a 10-year horizon, I don't know what you're seeing in your communities, but we tend to lose customers when they die. We don't intend to lose them, generally speaking, at least our core few thousand customers that we have.

So I do see those trends. And their kids are usually out of town or bank with a mega-bank, and they're not going to come back to us.

So that puts the pressure -- Robert, you talked about cyber risk technology, I think digital technologies keeping up with the large banks that have a huge budget, how do you compete? How does our mobile banking technology compete?

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How does our loan origination system compete?

I know a lot of us are in the relationship banking space, but even those relationships now are demanding much more of a real-time access to tools and technologies. For smaller institutions that percentage of that cost is a huge chunk of your ROA, compared to the large institutions.

And then, you know, I think the staffing is -- I just want to reiterate that -- I think that's a huge challenge. How do our banks compete and recruit?

We have a really great minority recruitment program to recruit minorities into banking, most of them that we've had, some have been with us for three or four years now, but some have been picked off by larger banks.

We trained them up and then they went out and got a big salary at a large bank, which is a great success for them and their family, but then how do we build that pipeline of talent

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coming into banking? Because, especially community banking, I think that's going to continue to be a challenge for us.

MEMBER WHARTON: Dominik, great points. In our breakfast, Robert asked a great question about the cores, and what do you do looking forward? I think that's a huge issue, for lack of a better word, I think we're held hostage by the major cores. And, you know, we need to reach out to third party but it's in many cases virtually impossible to do so, because, you know, they put restrictions, the fees, they make it, again, virtually impossible to interact with those third parties.

So, you know, what can we do to disrupt the big boys that, again, have so much control over us as community banks. Because I think one other thing we're seeing, the big boys -- not to name names, Wells Fargo and Bank of the West -- in our rural areas have abandoned community banking.

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In Steamboat Springs, when I moved to Steamboat Wells Fargo, had a 60 percent market share and 56 employees. Today they're now at 29 percent, we're at 28 percent, and they're down to 12 employees.

In Craig, Colorado, Bank of the West closed their branch. They had been number two and they've left western Colorado completely, so from our perspective it's a great time to be a community banker. But we also need the resources, and the cores are, frankly, a huge block to accomplishing that.

MS. OLESIUK: Thank you, everyone, for all of the comments. And I know I've learned a lot, so thank you very much.

MS. EBERLEY: Yeah, great discussion, thank you so much. So we're going to take a quick 15 minutes break and be back, if we could, at a quarter of -- I guess we're going to be just a little less than 15 minutes, but if we could come back a quarter of. Thank you.

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(Whereupon, the above-entitled matter went off the record at 10:32 a.m. and resumed at 10:50 a.m.)

MS. EBERLEY: Okay, I think we're ready to pick back up. Welcome back. Yesterday, we had a meeting of our Minority Depository Institutions Subcommittee. And Gilbert Narvaez serves on both this Committee and the MDI Subcommittee. And Gilbert and Betty Rudolph, the director of our Minority and Community Development Banking Office, are going to provide us with an update on yesterday's meeting, and a few other matters. So I'll turn it over to Gilbert.

MS. RUDOLPH: Thank you, Doreen. Just a few introductory remarks before we turn it over to Gilbert.

This committee was established, the MDI Subcommittee, in 2019, under the Federal Advisory Committee Act, so there's certain rules that go with that and require that the MDI

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Subcommittee provide any advice and recommendations to the FDIC through the Advisory Committee on Community Banking.

So they are not able to provide advice and recommendations directly to the FDIC, so they actually report, this subcommittee, to all of you and not to the FDIC.

And when we established the subcommittee, it has three goals. One is to serve as a source of feedback to us on our strategies to fulfill statutory goals that we have to preserve and promote minority depository institutions. There are about 144 MDIs that we insure and about 96 that we supervise directly.

The second goal is to provide a platform for MDIs to promote collaboration, partnerships, and best practices. And finally, to identify ways to highlight the role of MDIs that they play in their communities.

So our subcommittee is comprised of nine executives, representing all types of MDIs,

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African American, Native American, Hispanic American, and Asian American, and a range of business models, size, and geographic mix.

In addition to those nine executives, we have four MDIs represented on this committee, so we have Dom and Andrew, and Robert, and Gilbert.

So, we've had two meetings of our subcommittee since we last briefed this committee last November, a year ago. And so we met earlier this year on May 23, and then again yesterday, as Doreen said. So I'm going to turn it over now to Gilbert who will provide kind of a recap.

MEMBER NARVAEZ: Thank you, Betty. At this time, the MDI Subcommittee does not have any recommendations to the FDIC, but the Subcommittee does want to share a brief recap of the past two meetings.

At our May 23 meeting we discussed current banking conditions and unique issues facing our institutions. Many of the themes

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included a recovering economy, earnings improvements, hot real estate market, labor and supply chain issues, rising cost of materials, competing rates with the large banks, and growth of mobile and online banking services.

We reported that we were closely watching economic conditions related to the inflation, rising interest rates, and loan demands. During the MDI spotlight, one of our members, Angel Reyes, president and CEO of Centinel Bank of Taos, shared the processes the institution uses for strategic planning and succession management.

At the members' request, we also had a briefing of CECL methodology, available resources, and the current timeline.

We also had a briefing on the Community Reinvestment Act modernization, including comprehensive discussion with the federal banking agencies, joint notice of proposed rulemaking, released on May the 5 of

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2022. The briefing included a spotlight of interest of MDIs as proposed in the rule.

We also received a demonstration of the new research tool that the FDIC has developed to highlight census tracts with significant minority populations and shows where existing MDI community banks and non-community bank branches are located.

The tool would enable organizing groups to identify potential communities for the de novo institution, or support existing MDIs, and identifying market opportunities.

Finally, we received an update on the creation of the new Office of Minority and Community Development Banking and current projects.

At our meeting yesterday, we again discussed our local banking conditions, some key themes, including record earnings in many banks over the past year and into this year as well, but challenges expected over the next two years,

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strong asset quality, the pressure on deposits with rising rates, and also difficulties in recruiting and retaining talent, which was discussed by us this morning, as well.

During the MDI spotlight, we learned about the U.S. Treasury's mentor prodigy program that pairs up large institutions with MDIs to help build scale and capacity to potentially compete on numerous banking services provided by the Treasury.

Two of our members, Jim Sills and Alden McDonald, shared the benefits of their partnerships with JPMorgan Chase and Citibank.

We concluded our meeting with a round table discussion about some of the challenges and opportunities raised by the Emergency Capital Investment Program and the economic environment. We also provided feedback on FDIC MDI program opportunities.

This concludes my report from the MDI Subcommittee, and Betty and I welcome any

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questions that you may have. Questions?

MEMBER MJARTAN: I am curious what the biggest difference is between what this feedback was and what you heard from fellow MDI banks?

MEMBER NARVAEZ: I think we kind of mirrored -- maybe there were some more items that were brought up because, I guess, the number of participants. But Betty, I don't know if you have anything --

MS. RUDOLPH: No, I think it was very similar.

MEMBER MJARTAN: Were there any discussions about the CRA reform and how that could impact MDI/CDFIs?

MS. RUDOLPH: CRA did not come up in our discussion. I think when we had the briefing in May, we had a presentation. When was the last advisory committee here? Was it pre May 5 when CRA was issued, so you all didn't get a briefing on that? Is that right? You did?

MEMBER MJARTAN: Did not.

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MS. RUDOLPH: You did not? Yeah. So we got that briefing in May, and then now since we're in an open rulemaking timeframe, we sort of did not have a discussion on that, but none of the banks brought it up, either.

I think it is an opportunity for MDIs, and in particular I'll mention that one of the things that FDIC has been doing over the past couple months with OCC and the Fed is conducting some listening sessions of all -- we invited all 280 FDIC insured MDIs and CDFIs, and trying to understand what the needs are now, and there has been significant capital flowing in, as I think you and Robert and others talked about earlier today.

But there are opportunities. There are still MDIs and CDFIs looking for capital, they're looking for partnerships with regional banks, with larger banks. And so one of the things that we took back from that is sort of the need to continue to facilitate partnerships

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between MDIs and other institutions.

MEMBER JOHNSON: May I ask the range of size of those banks, the MDIs?

MS. RUDOLPH: Yeah, I think the smallest one is about 15 million and it's the bank that -- Robert's bank --

MEMBER JAMES: That we just bought, yeah.

MS. RUDOLPH: The bank you just bought, yeah, and I think the largest is somewhere around close to \$70 billion, in Los Angeles. So it's quite a range.

You know, we conducted a needs assessment a little while ago and, you know, the saying that came out of that was if you met one MDI or one CDFI, you've met one MDI or one CDFI. There are many issues in common, but they're unique business models. Different populations serve different histories. So it's not a one-size-fits-all is sort of our takeaway from that.

MEMBER JAMES: Yeah. Betty, I'm so

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sorry I missed the beginning of your presentation. And I want to thank you for all the work that you do on behalf of the sector, the mission-driven banking sector.

I don't know if Dom brought this up or if it's come up earlier, but just because of the influx of capital into a lot of our institutions, we're going to have rapid growth potentially. And a lot of times, rapid growth is met with, you know, growth and risk.

And so, I know that some of our members from the National Bankers Association have already started to request technical assistance on kind of, you know, preparing for that growth, preparing for risk, and how to manage the growth.

You know, are you thinking about doing some things, you know, for all of these banks to make sure that we're getting kind of coaching on how to add the assets, how to add the deposits, and how to manage risk at a different level?

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You know, our institution's going to be going from being, you know, two branches, \$50 million in total assets to now a multi-bank holding company with, you know, operations in multiple states, you know, probably quintupling in size over the next few years.

And so I wanted to make sure that we, you know, go flag that issue, and then make sure that we partner with the FDIC and the other regulators in order to kind of manage the growth prudently.

MS. RUDOLPH: Yeah, that's a great question. We have heard that from many of your members, and others.

So, for the benefit of the committee, the Treasury Department invested about 8.3 billion dollars in 162 MDIs and CDFIs -- that includes some credit unions as well -- earlier this year.

And in addition, a number of MDIs and CDFIs have had substantial capital investments

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from larger institutions as well, so we know there will be growth occurring, which is why the Congress appropriated that money and which is why the large banks sort of invested that in your institutions.

And so, we did a pilot with Doyle Mitchell from Industrial Bank a couple of weeks ago of some technical assistance, kind of walking through how we look at growth and sort of what you need to be doing to position your institution.

I will say it's mostly bread and butter supervision, so it's making sure you have the governance in place -- actually the first thing we talk about is reach out to your regulator early and often, making sure you have the governance in place, and the risk assessment framework for that growth, as well.

But there are actually no different rules, it's sort of our asset growth from our safety and soundness standards, and we walked

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through some scenarios on that. So we're getting ready, we did the pilot, we got a little bit of feedback. We're going to roll that out and invite every FDIC supervised MDI and CDFI to join us for that.

And in addition, we've developed some training that we're preparing to launch for examiners in charge of MDIs that are coming up for exams, and a lot of the content we used for that technical assistance is based on the training that we will have for examiners.

ACTING CHAIRMAN GRUENBERG: I was just going to say: it's a tremendous opportunity, but not without risk. And managing the deployment of the dramatically expanded capital that's now available to a significant number of MDIs is really going to be, to me, the critical challenge going forward here. And I know we want to be as helpful to the MDIs in managing the risks associated with it, and to be sure that they understand any supervisory issues that may be

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raised.

And Doyle Mitchell, I really give him credit, from the Industrial Bank of Washington, raised it with us, and asked for assistance. We were in some sense welcomed the opportunity to sit down with him to walk through the issues and sort of use it as an opportunity for us to develop a template of the sort for engaging with MDIs that have received the capital investment.

And I know Betty is now putting together a webinar that we'll make widely available, and certainly if the MBA would like us to do something specific for your members, we'd certainly be open to it. And I think we can also use our regular examination program to engage with individual institutions.

And then I would say any individual institution that has a particular issue or concern should just let us know and this will be a key priority for us.

MEMBER JAMES: Great, thank you. Can

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you talk a little bit about the training that's taking place?

Because, I mean, you know, from -- and Marty, you know this, too -- there's oftentimes such a disconnect between, you know, what's said in these rooms in Washington and what happens in the field in terms of the supervisory exam.

And, you know, kind of making sure that there's some, we're so excited to hear about this kind of training that's going to be taking place for examiners to make sure that there's some more connective tissue I think between the FIRREA, preserve and promote obligation, and what happens at the actual exam.

And what I mean by FIRREA, preserve and promote obligation for the rest of the board, so FIRREA Section 308, which is the actual federal statute that defines what an MDI is, it gives an obligation to the regulators, so the FDIC, the OCC, the Treasury, and the Federal Reserve, to actually preserve and promote

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minority depository institutions, and the unique character, the unique mission and role that they serve in all of our different communities.

And oftentimes there's a disconnect between that preserve and promote federal mandate, and what happens in the exam process. And that's not different than any other community bank, right? But it's particularly acute I think in MDIs, and so we're excited to hear about this training, and so I'd just love to hear more about how it's going to be rolled out and implemented.

MS. RUDOLPH: Yeah, so this training kind of stems from our update of -- our board approved our statement of policy regarding minority depository institutions last year. And incorporated into that policy, you know, regarding the examination program is what's already in the UFIRS standards and the compliance examination standards, which is to look at every institution relative to its unique business model, risk, and size and complexity.

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And so we reiterated that in the policy statement, and so this training is designed to sort of refresh examiner understanding of how to look at the business model. We've also developed a new tool this year to show the communities that are served by minority depository institutions a lot of census tract data and income levels, home ownership rates, demographics like that.

So looking at the unique business models. And then we have a couple of case studies that look at the inflow of capital, and sort of, you know, reminders about the safety and soundness standards and how to look at that.

And so, our examination materials are still in the final stages of review right now, but I like the way we're thinking about rolling them out, which is just in time training for the examiner in charge that's getting ready to go into that institution.

Did you want to add anything, Doreen?

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MS. EBERLEY: No, nothing to add, I think you covered it well.

Okay. All right, well, thank you. Thank you, Gilbert and Betty, for the update.

Next up we have Mike Spencer, who is Associate Director of Financial Risk Management, the Division of Insurance and Research, and Dan Hoople, who's the Chief of Fund Analysis and Pricing. And they're going to talk about the amended restoration plan and deposit insurance assessments.

MR. SPENCER: Thank you, Doreen.

MS. EBERLEY: Thank you.

MR. SPENCER: Thank you. Sure, thank you. Yeah, today, Dan and I are going to speak to you about the statutorily mandated restoration plan, why we amended it last June, and the related increase that was just approved by the FDIC Board.

Last week on Tuesday, October 18, we presented to the Board a final rule to increase

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deposit insurance assessment rate schedules by 2 basis points. The increase is meant to achieve two policy objectives, two complementary policy objectives: most immediately, to restore the reserve ratio to the statutory minimum of 1.35 percent by the statutory deadline of September 30, 2028.

Additionally, the rule supports growth in the Deposit Insurance Fund, or DIF, to progress towards the long-term fund management goal of a two percent designated reserve ratio.

Absent any further Board action, the increase will remain in effect until this goal is met. Importantly, not only will this action by the Board accelerate the timeline to meet these objectives, it reduces the likelihood that the FDIC would need to consider a procyclical assessment rate increase, especially when banking and economic conditions may be less favorable potentially at some point in the future, given the uncertainties and the downside risks facing

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the industry.

It should also increase the likelihood that DIF will remain positive through any potential future period of significant losses due to bank failures.

In the next few minutes I'll cover our underlying analysis, the scenario projections that we used to inform the Board in finalizing the rule and the expected effects on the industry, but I think first it makes sense to cover a little bit of the background and what led up to this point in the restoration plan.

I'm not sure of the last time we spoke to you about the restoration plan, I think it was probably when we first established it. It was first established during the height of the pandemic. On June 30, 2020, the reserve ratio fell below the statutory minimum of 1.35 percent and it stood at 1.30 percent. This was due solely to extraordinary growth in insured deposits in the first half of 2020.

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Our reserve ratio is our DIF balance relative to total estimated insured deposits in the system, so that's how you get the ratio. I think right now the reserve ratio stands at 1.26 percent today, and we have 124 and a half billion dollars, and the DIF relative to about 9.9 trillion dollars in insured deposits.

In that first half of 2020 we experienced about three years' worth of what we would generally expect for insured deposit growth in just two quarters. It really was really in a manner of about 16 weeks or so. And before the pandemic, as a reminder, the reserve ratio was at a high of 1.41 percent.

On September 15, 2020, the Board adopted a restoration plan to restore the ratio to the statutory minimum of 1.35 percent, and it was to -- within the statutory deadline. It's an eight year statutory deadline, and again that ends on September 30, 2028.

At that time the restoration plan was

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established, the Board believed it was premature to modify assessment rates, so the plan to maintain the assessment rates schedule, that was in place, and required staff to monitor the factors that could affect the DIF, reserve ratio, and update analysis and projections on a semi-annual basis, at least semi-annually.

Given the broad pandemic support and its duration, including two more subsequent -- not limited to, but including two more direct fiscal stimulus injections, the industry continued to experience strong insured deposit growth through 2021, and in the first half of 2022, insured deposit balances remain significantly elevated.

As of the last semi-annual update we provided to the Board in June 2022, almost two years after we first established the plan, insured deposit growth continued to outpace growth in the DIF.

And our projections for the reserve

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ratio at that time indicated that it was at risk of not meeting the statutory minimum by the deadline.

In eight quarters since the restoration plan has been in place, the reserve ratio has actually regressed, and as I said earlier, it's measuring 1.26 percent as of June 30, 2022. Because of all of this, the Board agreed to amend the restoration plan to incorporate a 2 basis point increase to deposit insurance assessment rate schedules and concurrently approved a notice of proposed rulemaking to implement this increase.

The proposal had a 60 day comment period. We received 171 comments from the public, which we carefully considered.

Commenters mainly covered our analysis and projections, and a key focus was on assumptions that we used for insured deposit growth and our investment portfolio.

And I'll say a few words about these

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two factors before going into a little bit of detail about our analysis and scenarios, and first I'll start by discussing insured deposit growth, which after all is the primary reason that the reserve ratio has declined so significantly over the last two years.

Now, as of the second quarter of 2022, while insured deposit growth has shown some signs of possibly normalizing, aggregate insured deposit balances, as I've stated, remain significantly elevated, especially compared to pre-pandemic levels.

To be clear, we estimate insured deposits to measure about \$1 trillion or more than what we would have otherwise expected, if not for the pandemic and the pandemic response. Insured deposits did decline in the second quarter. That's not unusual, insured deposits on a quarterly basis can be seasonal. Insured deposits have declined in the second quarter for six out of the last nine years.

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One of the quarters that it didn't decline was in the second quarter of 2020, when the CARES Act stimulus had direct injections of fiscal stimulus.

Additionally, year over year insured deposit growth remains strong at 4.3 percent, and this annual growth rate is higher than either of the growth rates we use in our two scenarios underlying the final rule.

While it's possible that insured deposit growth may slow in the future, it's uncertain. Insured deposit growth can be very difficult to predict given the many factors that can affect it.

Regarding investment portfolio performance, commenters did assert that its contribution would be stronger than what we assumed in our projections, especially given the rising rate environment.

However, growth in the DIF has been limited by a prolonged period of low returns, and

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recently by unrealized losses on available for sale securities, especially given the rapidly rising interest rate environment.

While we agree that a higher interest rate environment should eventually benefit the DIF, the timing of that is also uncertain when that would materialize, and since establishment of the plan a net investment portfolio contributions to growth in the DIF has been flat or negative.

I should add, though, that our longer term projection, so that's the 2 percent designated reserve ratio, it does assume a favorable level of positive net investment contributions after the reserve ratio reaches 1.35 percent.

Turning our attention to our scenarios briefly in support of finalizing the rule, we developed two scenarios that assume different levels of insured deposit growth, and average assessment rates to project when the reserve

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ratio would meet the statutory minimum of 1.35 percent, and then our longer term goal of 2 percent.

The two scenarios assume insured deposit growth rates of 4 percent and 3.5 percent, and assessment rates of 3.5 basis points and 4 basis points. And under these scenarios, without an increase to assessment rates, the statutory minimum wouldn't be met until the second quarter of 2034 or the fourth quarter of 2026, respectively. So either very well beyond the statutory deadline, or very late within the eight year period.

Each scenario is based on current and historical data, and to reiterate, the annual growth rate of 4.3 percent in insured deposits is below the annual -- the growth rates we assume in these scenarios is below what we're actually experiencing in the insured deposit growth rate of 4.3 percent right now.

So, even under the more favorable

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outcome, which is the fourth quarter of 2026, this assessment rate increase in the event timing would provide very little flexibility to prevent a larger procyclical assessment rate increase in the event there's an industry downturn between now and then.

Future economic and banking conditions could be challenged by high inflation, rapidly rising interest rates, slower growth, geopolitical uncertainty, just to name a few.

So given this timing and the uncertainties, when we applied a 2 basis point increase, it really demonstrated that this modest increase significantly accelerated the timeline. In fact, getting us there in about two years under each scenario, by or before the end of 2024. And we could possibly achieve the 2 percent goal by 2031 rather than 2042.

Regarding the estimated effects of the rule on the industry, our analysis indicates that an annual increase of 2 basis points in the

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assessment rate schedule would reduce tier 1 capital by .1 percent, and would reduce annual industry income by an average of 1.2 percent.

For small banks, the impact is less, averaging about 1 percent of their annual income. The industry as a whole continues to report favorable credit quality, earnings and capital levels, and is well positioned to absorb this modest increase of 2 basis points.

And in the end, the final rule, we believe attempted and has successfully balanced several considerations, and to reiterate, including really the goal of reaching the statutory minimum sooner rather than later, and it should help to strengthen the fund and reduce the risk.

Then we would need to consider a potentially procyclical assessment rate increase in the event of a future downturn or industry stress before the deadline.

And that would be at a time, if we had

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to do that when the industry would least be able to afford a raise in assessment rates, and it also improves the timeline greatly for achieving a 2 percent designated reserve ratio to strengthen the fund to withstand potential future banking crises.

So when does all this take effect? The final rule will be effective in the first quarterly assessment period of 2023, so that's January 1 to March 31, and the first payment would be under the new rate schedule June 30, since we assess in arrears and should leave enough time for the industry to plan for the change.

That concludes my prepared remarks. Thank you, and we're happy to answer any questions you may have.

MEMBER JOHNSON: I don't know if I have any questions, but we were -- last week, Wisconsin bankers and Illinois bankers met with some of your colleagues and they provided that information. So, thank you for being here and

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delivering the message to us. I think we, at the end, we all agreed that we'd rather, you know, pay out now than have to pay later and in a higher amount when it's more painful.

I did have one question that came up afterwards in our discussions, and not sure it's really relevant, but it's a question. I'll still do my duties in asking it. It's about the insurance level.

You know, we were all glad when it went from 100 to 250. I mean, it was time. So, we're very glad to have seen that. I don't know if it's been of any question now or consideration, of course, I'd say, it probably will -- would be higher assessment fees, but has there been any talk about that anywhere about raising that limit?

MR. SPENCER: I don't know.

MEMBER JOHNSON: Okay.

MR. SPENCER: Not that I'm aware of, no.

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ACTING CHAIRMAN GRUENBERG: And that would require a statutory change in Congress.

MEMBER JOHNSON: Correct, correct. But I was just curious to see if that was in any discussion at all.

But, okay.

ACTING CHAIRMAN GRUENBERG: One additional point, if I may, on the assessment issue.

By an additional virtue, and there is a virtue to it, by reaching the minimum reserve ratio earlier, it then restarts the -- you know, there's an eight-year clock.

So, when the reserve ratio falls below the statutory minimum, we're required by law to establish a restoration plan and we have eight years from that point to bring the reserve ratio back up to the statutory minimum.

When we restore the reserve ratio to the statutory minimum, it restarts the clock. So, we get a new eight-year period to restore the

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ratio, if necessary.

What that means is, if we bring it back up to the statutory minimum of 135, we get a new eight-year period which, effectively, puts us beyond the current economic cycle for having to deal with the issue.

So, and, you know, the two basis points increase, it's a little more than one percent of income which, frankly, we don't think should have much consequence for lending or credit availability.

But it really gives us a much higher assurance of getting to the minimum ratio, extends the cycle, a new eight years to put us out of this economic cycle, and strengthens the fund ahead of what could be, let's call it an uncertain economic environment going forward.

So, on balance, there's never -- I'm pretty confident talking to any banker group that's never particularly good time to raise insurance premiums. But thinking about the pros

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and cons, it made some sense to do a modest increase early when the industry and the economy is in relatively good shape and really sets us up so we're not going to have to impose a really procyclical increase, which is what happened in 2008.

I mean, if you all recall, and Mike you -- I think we did an assessment increase then a special assessment. And then, we had to have a prepayment of assessments. And we really want it -- that's really the scenario you want to avoid. And I think this gives us a pretty high probability of doing that.

So, on balance, it seems like the sensible thing to do.

MR. SPENCER: And it was at a time when the industry I think, on balance, had a negative net income.

MEMBER MJARTAN: Could you talk some about the percentage of that growth of the balance sheet that's in uninsured accounts? It's

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above 250 and how's that factored in? How does that play into the --

MR. SPENCER: And so --

MEMBER MJARTAN: -- and so forth, your outlook?

MR. SPENCER: Well, so, this is about insured deposits, which is a derivation of -- or a subset of total deposits. And that's what we measure the reserve ratio on. So, it's not taken into consideration.

However, from this fund management perspective, from a pricing perspective, banks are priced on the base, so their total base.

So, if they experience a lot of growth in all types of deposits, we determine a rate based on a risk-based pricing system. And we have two distinct systems for small and large banks.

And after we get that rate, we multiply it by the base and that gets your initial base assessment rate.

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Total, we have seen a decline, probably a bigger outflow, right, Dan, of sort of wholesale deposits. I think chasing the yield, you know, a little bit different than a retail deposit.

They have, you know, maybe a mandate, if I think of like a corporate treasurer or something like that, that's managing a wholesale deposit, they'll look for some yield or move money into a money market.

So, we have seen probably -- if we've seen some deposit outflow like we saw in the second quarter, those types of deposits have really been what has moved a little more quickly than what we've seen in insured deposits. They're much more sticky.

MR. HOOPLE: I would only add maybe a little bit of numbers to that, what Mike said is right. We do look at accounts above 250 uninsured deposits because it does give us a sense of the trend or deposits overall.

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Insured deposits is what drives our reserve ratio. But to put a couple of numbers to things, in the last quarter, we did see a quarterly deposit outflow of about 369 billion which was sizeable.

Most of that 282 billion was in accounts above 250. So, there is a lot of deposit outflow that's occurring, but we haven't seen as much of a decline in insured deposits because much of that has been in the larger accounts.

But it is something that we look at because we are interested in the trends of all deposits. Because it can be a signal for insured deposits as well.

MEMBER MJARTAN: Thank you.

MR. SPENCER: Sure.

ACTING CHAIRMAN GRUENBERG: Thanks, Mike. Thank you, that was very helpful.

MR. SPENCER: Thank you.

MS. EBERLEY: Okay, thank you.

We're going to now break for lunch.

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But before we go to the seventh floor, we're going to go down to the lobby and take pictures. So, I'll ask everybody to take the elevators down to the lobby level. We'll take our pictures and then we'll go up to the seventh floor. And we'll come back at 1:00.

(Whereupon, the above-entitled matter went off the record at 11:29 a.m. and resumed at 1:06 p.m.)

MS. EBERLEY: All right, well, welcome back, everybody. I hope everybody had a nice lunch.

Next up, we're going to spend some time, about an hour and ten minutes or so, talking about some supervisory and policy matters.

So, first up, joining me is Chris Finnegan from the Division of Depositor and Consumer Protection.

Chris is Senior Deputy Director in that division. And he and I are going to give you an update on our return to banks.

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And I'm going to kick us off. So, you know, as I reflect on this, I think back to March of 2020 and that Friday when we all learned we were going to be leaving the office and going on mandatory telework. And, you know, thinking we'd be out for a couple of weeks.

You know, two and a half years later, who would have thought, right? It was really just something.

But I think it's really fortunate that we had laid the groundwork for offsite operations through efforts that we really started at FDIC in 2016. And we undertook those efforts for examiner retention, you know, examiner travel is one of the biggest reasons that we lost people pre-pandemic.

And so, we wanted to -- we had the ability to do work offsite. We wanted to expand that. We talked to examiners to understand what were some of the hurdles. Some of them are just, you know, really not believing that we meant it

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when we said they could it.

And so, we updated our policies and procedures and talked about the types of work that were appropriate to be done offsite.

And we started working on some tools that would help us be able to work offsite more effectively. And through this process, by the end of 2019, we had really increased the percentage of safety and soundness exam work that we were completing off site.

We go back to 2016, it was about 32 percent of our exam hours. And by year end '19, it was 47 percent. So, fast forward to March of 2020, it was a 100.

And so, we operated under this mandatory telework until this past April. And that's when we moved into the second phase of our return to office plan. We call it RTO. And that was maximum telework. So, under that scenario, staff were permitted but not required to return to the office.

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And we did return to banks during that whole period of time when we had to. If we needed to go to a bank, we went. But they were pretty few and far between.

And I would say that, you know, although the mode of operations was functional and we were able to carry out our examination program through that whole period of time, it was not optimal.

Efficiency, we lost a tremendous amount of efficiency during that period of time. And it really was noticeable within the first couple of weeks of transitioning.

And it took us a lot longer to do our work. I noticed that when, very early on, I read some reports of examination. I was just curious to see what examiners were saying about how bankers were responding to the national emergency and how they were adjusting their operations.

And I was surprised, in every single report, I read about 20, it might have been 40

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actually, but in every single one, the examiner said it took them much longer to complete the examination than they had anticipated or scheduled.

And so, after the first couple of months, that number bounced around a bit but it settled at about 40 percent. And so, it's taken us 40 percent longer to do our work throughout this entire period.

Anecdotally, I've heard as examiners have gotten back into financial institutions in the last, you know, what, six, seven weeks, they are experiencing some efficiencies and picking back up some of the time that we lost operating offsite.

I don't have any numbers to attach to that yet, but looking forward to seeing that.

And they certainly have been happy to be back in institutions and talking face to face with bank management. And I hope you're feeling the same way those of you that have had exams

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since September 6th.

And that was when we moved to our new hybrid work environment which is phase three of our return to office plan.

So, as of that date, every safety and soundness exam will have an onsite component.

The new hybrid work environment expanded flexibilities to all FDIC staff that we had offered to our exam staff pre-pandemic, which allows folks to work from home when they didn't need to be at a financial institution or in the office.

We conducted, I mentioned, a limited number of in person exam activities after those last two and a half years. And as we've moved into this hybrid environment, the one thing that you're going to see that's really different from what it looked like before the pandemic, is not every examination team member will be at the bank.

So, when we think of the hybrid, we

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will have an onsite component for every examination, but maybe not the whole team. The folks that need to be there will be there.

And as we thought about this, we really drew lessons learned from our work during the mandatory telework period through internal reviews that we conducted and focus groups.

And then, we also considered the responses that you shared with us pursuant to the request for information that we issued.

So, a few things that we learned and be eager to hear from you how they're working and what your thoughts are, but cameras on for virtual meetings, right? That was a big one. That was an adjustment for folks moving to Microsoft Teams and having to deal in that kind of environment and getting comfortable with it.

Developing and agreeing upon communication plans up front, super important when we're not all together. Not just between bank management and the exam team, but amongst

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the exam team when they are all not working in the same place.

And then, adding some new technology to help us. And so, we're still working on some tweaks to how we use Microsoft Teams to make collaboration easier with banks.

And it's actually using Team Sites. Our counterparts in DCP actually were the ones that kicked off this project. And so, we're following behind and joining them.

But we do think that we can use Microsoft Teams more effectively for those examiners that are not part of the onsite examination team.

And also, just for collaboration and making sure we're keeping track of requests, not asking for things twice, having good communication, and also, working more closely with our state counterparts.

So, that's just a little overview of where we are from the safety and soundness side.

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And I'll ask Chris to give an update from the compliance side.

MR. FINNEGAN: Absolutely.

And good afternoon, everybody. I agree with the Chairman, it is nice to be back and see everybody. This is great.

And not only during the pandemic over the last two and a half, three years ago, I actually accepted a new position with the FDIC. So, I had a big change. I took this role about a little over a year ago. So, and I oversee the consumer compliance and fair lending and CRA issue exams.

And, you know, I can echo a lot what Doreen said on return to bank, you know, we've been going for about a month now where, after Labor Day, pretty much all of our exams will have some type of onsite presence going forward.

But, you know, what we had done -- I'll go over a little history of what we had.

We had looked at this for several

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years, even before the pandemic about what we could do onsite versus offsite for a variety of reasons. One, being less onsite and still being effective, and then, from retention and a variety of other issues that we were looking at.

So, we, over the five years, we had about a 36 percent of exam hours were offsite in 2016. And by the end of 2019, even before the pandemic, we were about 65 percent offsite.

So, you know, that's averages. So, you know, some banks would be more, some would be less. But we were trying to do as much as we could effectively and still being efficient and doing, you know, a solid exam with doing onsite versus the offsite.

So, but then, we went to a 100 percent offsite, as Doreen said, you know. And that was a challenge and we definitely appreciated the relationships we had with the bankers during this period to make this work. Because it was a challenging time for everybody.

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But we did learn a lot over this period of time, even though we were already doing a lot of activities offsite. But when you go to a 100 percent, you've got to be flexible and try that. Because you still had a bank to run and all of those kind of things.

And we needed to make sure that we were doing our exams the way, you know, we needed to do it. But at the same time, understanding what y'all were going through during that period of time.

So, we have learned a lot. What Doreen talked about, you know, we actually had a project where we put together all the lessons learned, similar to the cameras.

What can we do, you know, effectively offsite? What can we do? What needs to be onsite?

We got a lot of feedback during this period time that, it was interesting, a lot of bankers would tell me about, we are looking

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forward to you coming back onsite. Now, not a 100 percent, we don't need you there all the time, but, you know, come onsite because we, you know, we developed the relationship.

There is certain things that we need to do onsite, whether it be certain discussions, certain reviews, you know, for CRA. And we do CRAs, so actually being in the community and seeing what's going on.

So, going forward, though, was so after, we called it phase three, after Labor Day, all of our exams that start after that date will have some type of onsite activity. And it's going to depend on a variety of things.

So, we're going to look at your business model, risk profile, complexity, your ability on loan file imaging, technology capabilities. The, you know, whether there's other exams that have been going on. The ability to collaborate on joint activities.

So, we're going to look at a variety

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of things to determine how much onsite we're going to do versus offsite. So, I think it's just going to depend on the risk and what we've seen there.

But we have learned. So, several things as we go through, but we're always open to whatever feedback, you know, to make our exams, you know, as effective and efficient as possible, but very similar to what Doreen's team is doing on the safety -- on the consumer compliance side.

MS. EBERLEY: So, we'd be happy to have any feedback you want to share or answer any questions.

I should add, we accept feedback at the very beginning of each examination, too, through the examination planning process.

So, you should expect your examiner in charge to have a conversation with you on both sides of the house about what's the communication plan for the examination, who's going to be onsite? When are they going to be onsite? What

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are we going to do onsite? What are we going to offsite?

So, you'll have an opportunity to talk to them about that.

MEMBER CAMPBELL: Yes, we just finished an exam probably about six months ago and it was a safety and soundness.

And the exam, you all became very efficient with your process. The communication plan up front establishing set meeting times, incorporating, you know, key personnel and making sure, you know, that even within IT was part of it.

So, they had their set meeting times. We had our overall executive management set meeting times, loan review times, and I couldn't have been happier.

MR. FINNEGAN: Good.

MEMBER CAMPBELL: You know, I like the face to face, I like the camera on. You know, because I think that's, to me, that's the key is

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making the personal connection. I mean, that's what we do as community bankers.

And so, being able to be face to face, I think if these were done by audio only, it would not have been a successful thing for us.

That being said, we're looking forward to, you know, having examiners -- wow, I never thought I'd say this -- examiners back.

(Laughter.)

MEMBER CAMPBELL: Examiners back in the office, because we do enjoy like building relationship. And I think whenever, you know, whenever you have that give and take, there's learning opportunities on both sides.

So, we've found in our most recent exams, we found examiners who ask questions, who try to understand, and I think, overall, the tone of the examination process is probably the best that I've experienced. I've been at the bank for 31 years. But I think you all did a great job with the virtual.

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MS. EBERLEY: Thank you.

MEMBER REIGELSBERGER: I might add, too, we just had a FDIC exam this summer. I thought it went really well. Like you said, the communication decisions up front and how we're going to get to, you know, how we're going to get 2R scanned, and imaged credit files, such as that.

I really appreciate the amount of time that's given us to get these documents uploaded. It was at least six weeks and we needed every single bit of that. Because there's only five or six of us that work on that and you worked that in when you got a little spare time.

Now, there was a lot of information, page after page after page, but we got it done. And I think that was probably helpful on the exam side. We really had very little times where somebody said, well did you --

Because sometimes the same document might be needed for a couple of different views.

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And I don't -- I mean, we might have had that once, but I mean, I feel like some point that's to be expected.

But I think what I looked for, that little bit of hybrid that you're talking about, sometimes when they're sitting in your office and you have conversations about something which can lead to another conversation that you wanted to have, and you push leads. And you kind of have a good round about different topics, not just the one.

Whereas, on a phone call or even the Teams meetings, you address what is on the agenda, what's the list. I want to get back to work now. You don't swing around and talk about other things that kind of is in the back of your mind, but maybe isn't a priority.

But if you're sitting right here and you're having a discussion, I always felt like we kind of missed out on that.

So, and the connection, like you said

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with your local examiners, I have a lot of respect for them. They've always been very common sensed, you know, very sound. And so, I always respect their opinions.

And I feel like having that little bit of a hybrid where we can get stuff and shoot it to them so we're not invaded. But on the other hand, have a little bit of face to face, just for those conversations. It's kind of what I've seen.

MR. FINNEGAN: Yes, agree. Agree completely.

MEMBER LOWRY: I'd like to mention also, I really am in favor of the hybrid model.

We are always a training bank, pretty simple operation and all that. So, we end up being a training bank.

And there's been times in the past where physically, we're strained to have the number of examiners. I mean, we're \$350 million bank and we'd have 16 examiners onsite, which is

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difficult to accommodate physically and IT resources and all those kinds of things. So, I think the hybrid is great.

We had our -- we had an exam right after this stay at home, work at home thing came in to about. And it worked out, but it was a little bit of a rough start. We were trying to figure out the communication piece and all that.

And we've had, I don't know, three since and that's been fantastic. But those pre-meetings that you had talked about where we get together and establish just expectations, I mean, we just set calendar meeting times every day here's the people that are going to be in it.

And sometimes, it was very quick and sometimes, you had to, you know, delve into things a little bit.

But so, I think the hybrid is really where we need to be.

MR. FINNEGAN: Yes, that's good feedback. We had heard that, the feedback on

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setting up those meetings. Because, you know, calling out of the blue, you know, and all that. And then, actually having a good communication strategy, it seemed to work out well.

We, over a period of time, we learned that for sure.

MEMBER LOWRY: I would also add, though, there's a huge benefit to, like Kim talked about, of having an examiner there. Because the piece that you missed was the aside conversations, you know, that the discussion in the break room when you're talking about just life or, you know, current events or whatever.

And then, it would lead into something that's not necessarily specific to the exam, but got really good discussion feedback.

And that's where those relationships get built. And we had talked about that at lunch a little bit today with Chairman Gruenberg of --

I feel like the last four or five years, the FDIC has been much more interested in

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developing relationships with bankers than prior to that time. And I think it's huge to do that.

MEMBER MJARTAN: Doreen, if I can add just a couple points.

I want to commend you and your team during the pandemic, too, not just the examination process and how supportive you were, but also recognizing the work we're doing in the community.

So, everything from doing initial deferrals then the PPP loans. So, you know, we did 1,300 PPP loans out of our bank at 500 loans on our books when the pandemic started. So, we were really stressed.

And I think your team did a fantastic job just recognizing that. I don't think they cut any corners. I felt the pain, but they were very helpful and understanding and so that was one point.

And so, you know, we're on a -- that 18-month cycle, so we had two experiences.

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And I also want to make sure that I share some of the feedback, the technology piece was really critical. So, we had laptops with VPN ready. We ordered a bunch of them in advance. So, having that advanced conversation, that allowed us to staff up, too, in terms of technology.

The cadence, having regular meetings, but also, I don't think it would have changed the outcome of our exam in any material way, but the one that we were much more sort of distant, there was a lot more friction because those examiners were not onsite.

We missed a lot of communication. And we eventually caught it up, but it was a lot of unnecessary friction, in my observation.

So, I do appreciate you bringing the team back onsite and I think that should be more so than less so, in observation.

Because it -- actually, on a smaller bank, when I started, at my current bank, we had

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12 employees and we had 17 examiners onsite on one exam. But it still was a lot smoother than if we had done it remotely fully. It just -- the communications was much better.

So, I just want to encourage you and appreciate what you've done in making those transitions, but also, I want to make sure that the hybrid, in our experience, it should be more so onsite and in person than just kind of shifting it off to the Zoom or Teams meetings.

MS. EBERLEY: We're going to try to strike the right balance.

MEMBER JOHNSON: It sounds like you do have a good balance, though, on your plan. That sounds very good because I would be the outlier all the time saying, you know, offsite, that's fine with me as long as we communication, right, in circumstances.

But hybrid would be welcome, very welcomed. So, I agree with what's been said.

A couple things I'd want to put out

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just talk about, is exchange of information and how we handle that.

I'm all for the efficiency and effectiveness for both of us and how that works. So, we've talked a little bit about five, we were a beta right away. I signed us up and then I asked my staff later for permission. Is that okay? We'll figure it out?

It needs some work if it's going to go forward. So, I encourage anybody involvement and getting some other people involved in this. So, if you would correspond back with any of us about how that's working, I think it's great.

And FDIC connect, it's come a long ways and we're so glad. I think it works great. Anything -- I haven't filled ombudsman report out, but I will because it's positive things and they need to put that in there.

Even when we file things in there, I do ask examiners a follow up. But, you know, it's over and they need to move on to other

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things. So, it's kind of things maybe get shuffled, maybe, yes, yes, that works well, it's fine.

How do you use more detail, want to put them in folders? We don't get any description of that. But if they want to, anymore detail of instructions of how to file some things easier for you to find and vice versa.

So, I'm all in favor of working together on that.

And the State of Illinois tried to find their, you know, own system, unsuccessful. So, obviously, I don't know if all the states are using FDIC Connect, but thank you. I don't know how -- who said what and agreed, but thank you because they scrambled.

They were going to come back to this in onsite. I hope that's not all true because I know there's a huge savings as well. And retaining people. And we've lost a lot of expertise in there.

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We've had a lot of good examiners that I've known. We've had some come back and consultants, so, I was glad to see some of those, very welcome to that.

But, you know, a savings and somehow, the State of Illinois I think needs some monies, so, we're hoping they form some type of hybrid and maybe suggest they reach out to you to find out what they're doing. I'm sure you'd be in communication with them.

But so, thank you.

MS. EBERLEY: Thank you. We do continue to work on five making it more scalable. It's still about 50 percent of banks that image loan files, so it's not the whole industry.

MEMBER JOHNSON: Right.

MS. EBERLEY: And what we've learned through our work over the last five years as we went down this path is that the imaged -- the industry that does loan imaging is pretty fragmented.

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And so, for us to scale, we've got to work with a lot of parties.

MEMBER JOHNSON: Which a core could come out of this.

MS. EBERLEY: We're still heading down that path and I appreciate that and we've got some automation to help make it a little easier as well.

MEMBER JOHNSON: Anything we can do.

MS. EBERLEY: Thank you.

MEMBER WHARTON: Mr. Finnegan, for the consumer compliance exam, speaking from personal experience, ours was May of 2020, so very early into the COVID response. And two things that happened with us, first, being, scoping became a word that everyone of us lived and breathed.

And from our perspective, the challenge was our exam was to be I believe June 3rd, but under the auspice of scoping, we were basically going to an exam for four weeks prior to June 3rd. And I had three people that tracked

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their hours, and it was in excess of 120 hours that they devoted.

So, just going back to best practices, my first question is, has that been addressed and how will we approach that in the future?

MR. FINNEGAN: Yeah, it's a great question. Thanks, John.

Yeah, that, the pre-exam process is something that we've evolved over the years with the idea that we could -- I mean, we'll look at the risk of the institution. So we gather that information so that our exams are totally focused on what we think is the highest risk, you know, at that institution.

And that's why, that's how it was designed, to gather information up front, look at it. And then the scope that you're talking about is where the examiner will look at it and say these are the highest risks, this is what this exam is going to focus in on for consumer protection, whether it be, you know, mortgage

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loans or car loans or whatever it is, you know, fair lending, you know, what are we going to look at.

But we have heard the feedback on the amount of time it takes during the, we call it the pre-exam planning, PEP process is what we call it, and about the amount of materials that we request during the PEP or PEP system, and then using that information and making sure that we're not asking for more than what we need in order to, you know, evaluate the risk of the bank.

We do, you know, after every exam, there is that feedback. And we do get feedback that our examiners are asking for a lot of information, and, you know, is there a way to, you know, to cut it back, and are you really needing all of this information.

So this is something that we're regularly looking at, you know, our process where it's always going to be risk scoped, because we're just not going to go in and look at

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everything. You don't want us to do that. So it's going to be a risk scoped process. But we were regularly looking at the questions that we ask, that process, and is there a way that we can make that more efficient.

So your point is well taken. This is something that we discuss with our examiners, look, you get the information you need, but don't, you know, don't just ask, you shouldn't be asking for everything. It's supposed to be risk scoped based on -- we do an interview up front. And then that is supposed to dictate what we ask for from the banks.

So it's a regular training issue that we do. But we're also looking at that process, too, of the questions that we have, because there's a bank of questions that we have and do we need to be, you know, asking all these type of questions and all that.

So your, yeah, to answer your question, this is something we regularly look at

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to try to make it as efficient as possible. But the whole point is to look at that so that the onsite is really only focusing on the highest risk. That's why we do it.

But we are looking at that PEP process just to make sure that it's as efficient as they can, while still doing what we need to do as far as the exam goes.

MEMBER WHARTON: Got you. Second question was --

MR. FINNEGAN: Yeah, sure.

MEMBER WHARTON: -- it sounds like you've addressed this. But with the FDICconnect, same situation, we had downloaded, you know, immeasurable amounts of information, and then we started getting calls and said, hey, can you just send that to me directly --

MR. FINNEGAN: Yeah.

MEMBER WHARTON: -- via encrypted. And again, it was May of 2020. A lot has changed since then. So we're like, well, wait a minute,

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it was in FDICconnect. Well, can you just send it to me?

MR. FINNEGAN: Yeah.

MEMBER WHARTON: And that happened over and over and over. Has that been addressed?

MR. FINNEGAN: Yeah, we got that feedback too. And the answer is yes. I can't promise you that that won't happen.

But we do remind our examiners regularly that we have an official process that we go through to get the documents, and again, don't ask for more than what you need to do the risk scoping of the exam, but use the documents that you get.

And now, sometimes they may, you know, something may, they may not find it or whatever, and they'll ask. But --

MEMBER WHARTON: Sure.

MR. FINNEGAN: -- they are supposed to be going through that system versus trying, because, one, security. We want to make sure

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that that information is secure. But this -- what I've learned in this role is this is a nationwide organization. We've got examiners all over. But we regularly talk about that very thing, so yes.

MEMBER WHARTON: Thank you.

MR. FINNEGAN: Yeah.

MS. EBERLEY: It is EFX now, yeah.

MR. FINNEGAN: Yeah, EFX. But FDIC could -- it goes way back, so yes.

MEMBER JAMES: Doreen, Chris, thank you. Thank you for the presentation and the information.

I want to echo the encouragement of going with the hybrid model, because it -- and it is a balance that you've got to strike, because we've got, you know, a very small staff at our local bank in Savannah, you know, less than 20 people. And we have had times when we've had examiners fill up the whole parking lot, you know, and customers can't get in. And so having

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that hybrid approach is I think going to be helpful.

And, you know, to the degree that we can focus the in-person examiners on the highest risk items, I think that makes sense, because there is that sort of natural conversation that can be beneficial. But then there's also that conversation that can start going down a rabbit hole. And, you know, the conversation can start in one point, and then you go down a rabbit hole and it starts opening up cans of worms that -- you know, I'm mixing metaphors here. But you get my point.

(Laughter.)

MEMBER JAMES: I do wonder -- and I also want to just thank both of your teams for being very flexible with our team. We had a joint safety and soundness with the State of Georgia and a compliance, a consumer compliance and CRA that were all overlapping in the first quarter.

And so I know that there were some

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patience that was shown on the CRA portion because we were so busy doing consumer compliance and doing safety and soundness. So we got some extra time to respond, which was really, really helpful and allowed us to be more, you know, complete in our responses on the CRA than we might have had we had to rush and do everything all at the same time.

How do you decide what elements of the exam are going to be in-person versus hybrid? And how are you all making those determinations?

MS. EBERLEY: The examiner in charge is going to make that determination working with their supervisor. And that's in the pre-exam planning process.

And so the first thing that the EIC will do is consider where's the information, you know. So a key question is does the institution image or not. If an institution doesn't image, we're going to do loan review onsite. If they do image, we can do the loan review piece where we're

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not interacting and we're just reading files offsite.

But we do have in our manual of examination policies, which is on fdic.gov, listings of the types of activities that we would expect examiners to do offsite. And that's basically when they're reading, right, when they're not interacting with you.

When they're interacting with you, where they're transaction testing against systems, that will be onsite. Management discussions will be onsite. Those are the important things.

So they'll develop their plan. And it's based on the business model, risk profile, and complexity of the institution. So those are the things that they're considering.

They'll be having conversations with you before they ever step foot in the bank. They'll develop their plan for what procedures need to be completed in order to evaluate the

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risk profile, business model, and complexity of the institution.

And they'll also have to take into account training. So they start with the risk focused process. There may be things we have to add on for training purposes.

And then we'll decide, they'll make the decision with their supervisor who's going to be onsite, who's going to be offsite based on the functions that those folks will be working on, the procedures they'll be working on.

MEMBER JAMES: Thank you.

MS. EBERLEY: Okay. Well, we can move on to our next topic, which Chris is going to stay up here and handle. So he's going to talk about our supervisory guidance on multiple representation NSF fees that was issued in August of 2022. And then he is also going to discuss fees associated with authorize positive/settle negative transactions.

MR. FINNEGAN: Okay. I think we have

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a couple of slides that we brought up. And I think when I met with you all last time, you know, through Teams we talked a little bit about re-presentments and, you know, where we were with that.

So I thought I would update you, you know, on some things that have happened since we met last. And, you know, this issue has been out there for a while and some things that we've adjusted on, as far as our exams.

But, you know, we've talked about -- you know, I think everybody is aware of what a re-presented transaction is, is where, you know, it's an item that comes in, and, you know, the customer, you know, doesn't have enough funds to cover it. And they'll get charged an NSF fee, which, you know, we've seen that where it's being disclosed where they get charged the NSF fee.

But what would happen is is that item will get re-presented by the merchant, right. And so that's what we're talking about here when

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I talk about re-presented transactions.

And what had come up was, you know, it was coming up from our exams. I had noticed that in several instances where the disclosure we did not think was adequate to disclose to the customer, that re-presented fee would have been disclosed to the customer. So that's the fee. We're not talking about that first fee. It's on that re-presented transaction where a fee was being charged.

And, you know, this is kind of blanketing, but we saw a lot of disclosures where it was not being disclosed adequately. And we had a conclusion that in certain instances that it would be considered deceptive, because basically it was not being disclosed adequately to the customer.

So we started seeing this. And it was, you know, at several institutions where we saw it. And we were hearing, you know, from our examiners, as well as from the banks, about this

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being brought up at a lot of exams and, you know, a lot of concern about us doing this. And, you know, and the process that we were going through in order to, you know, to cite, one, you know, citing the violation, you know, unfair or deceptive act of practices, you know, is a difficult, you know, violation to hear. And we recognize that.

But, you know, we did think there was consumer harm going on. And we did, you know, we have had instances where we have found it to be deceptive. We have not had any instances where it's unfair. But we have had where it's deceptive.

But based on the feedback that we were getting, we had mentioned this originally in our supervisory highlights journal from earlier this year, in March of this year, because we started seeing this in 2021. And so our supervisory highlights basically highlights what we saw in 2021. So we mentioned it there.

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But we were getting feedback that, you know, a lot of banks didn't realize this was an issue. And we need to do something more.

So we issued our FIL, you know, our Financial Institution Letter, back in August where we put more information in there about, you know, the concern that we had with the, with this fee and not being disclosed and then some mitigation factors that, you know, banks could do in order to address that. So that's why, you know, we issued this FIL back in August.

So there's a lot of good information in there, which we think about, you know, how to mitigate the issue where, you know, you can decline the charge when there's more than one NSF fee for the same transaction, eliminating the NSF fees, and then making sure you're providing the clear and conspicuous disclosure that explains the amount of the NSF fee.

We also put in there, though -- you know, we've had a longstanding process here. You

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know, it's in our compliance examiner manual, that self-identifying, you know, banks that self-identify and self-correct issues, you know, we, as long as it's, you know, you self-identified, you fixed it, we will not, you know, it's not part of something that we would cite as part of an exam. So we did a reminder in this FIL about doing that.

You know, so we've also heard, you know, about some of the difficulty of identifying the transactions, because when we talk about full corrective action when we believe that there's a deceptive practice, it's not only correcting the disclosure, but it's also making restitution to the harmed individuals, which we did think there was consumer harm here.

You know, we've met with a lot of different trade associations. We've met with a lot of different groups to getting feedback, you know, on the process that we've got going.

So we did, you know, put in here some

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flexibility on the restitution. It's in this FIL about how banks can go about correcting this issue so that hopefully when the exam comes up this would not be a violation going forward. I mean, that's the idea of one of the reasons why we put the FIL out.

You know, there's a few other processes that we're doing. You know, we're meeting with different groups. We do understand the difficulty with the core providers of identifying these transactions. So we've had meetings with some of the core providers. And we're planning on doing some more meetings with that to help the institutions be able to identify these transactions as part of this process.

So there's been a lot of kind of activity with this since we were here last on it. But the big was I wanted to point out was that we had the FIL that came out.

There's a lot of different -- we talked about the risk. We talked about some of

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the risk, the mitigating practices and a good reminder about that we won't cite the violation if it's self-identified and corrected, which includes that restitution piece in there.

So that's the highlights of the representations. Any questions?

MEMBER WHARTON: It's really helpful. Thank you.

MR. FINNEGAN: All right. Thanks, John. All right. And so the next thing then I will mention is the, as Doreen mentioned, said that I was going to talk about was on the issue called the authorize positive/settle negative.

And this is an overdraft issue that, you know, that's been around a while. So we're going to just highlight it again today that you'd want to go back and see how your bank is processing these transactions.

But basically what that is is a transaction, which a bank assesses an overdraft fee based on insufficient funds at the time of

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settlement even though the customer has sufficient funds available when the consumer entered into the transaction. This is elevated when the bank utilizes an available balance method to assess overdraft fees as opposed to the ledger balance.

And we found it difficult for consumers to understand the balance in their account, especially when there were pending transactions and authorization holds.

And I mentioned this has been around a little bit. We put this in that supervisory highlights that I mentioned from March of 2022 where we talked about re-presentments. This was in our June 2019 supervisory highlights. So I wanted to bring that up today. You know, the CFPB had a recent case of a large institution where this issue had come up.

So, again, we wanted to make sure our banks are aware of the risk associated with this and make sure you understand, you know, how your

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system is set up to do these type of transactions, because this could be potentially a UDAP violation as well. So okay. So any -- all right.

MS. EBERLEY: Okay. Well, thank you, Chris.

So next up we're going to be joined by a senior attorney, Rhonda Campbell, from our Legal Division and Jonathan Miller, who is Deputy Director for Policy in our Division of Depositor and Consumer Protection.

Rhonda is going to share with you about a final rule we issued in May relating to misrepresentations about insured status. And she'll also cover the FDIC portal for submitting complaints about suspected misrepresentations regarding deposit insurance. And then Jonathan will talk to our, talk about our request for information relating to advertising and FDIC logos. Thanks, Rhonda.

MS. CAMPBELL: Hi. My glasses are fogging up. I might as well take that off.

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Good afternoon. Again, I'm Rhonda Campbell. I'm in the Consumer Enforcement Unit of the Legal Division of the FDIC.

This is slide 9. The FDIA Act prohibits, one, the use of the FDIC name or logo or any terms or symbols that imply that an uninsured product is insured and, two, knowingly making misrepresentations with respect to the extent or manner of deposit insurance. Next slide.

In recent years and actually in this year alone, the misuse of the FDIC logo and misrepresentations of deposit insurance by third-party financial services providers or other entities or individuals has increased dramatically. And this increase has highlighted the need for further clarification and of further clarification of the statutory and regulatory prohibitions against misuse and misrepresentations under Section 18 of the FDIA.

And to address this issue, in May of

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this year, the FDIC issued a new rule, which became effective I believe July of this year, July 5th of this year. And the final rule provides transparency into FDIC's procedures and standards for identifying, investigating, and evaluating misuse and misreps, and if appropriate, allows the FDIC to take action to address misuse and misrepresentation of deposit insurance.

Of note, the final rule does require non-insured entities that advertise deposit insurance to identify the insured depository institution, meaning the bank, that will provide deposit insurance. Next slide.

Types of deposit insurance misrepresentations that we have seen, we've seen fraud or hopes websites that are generally used to garner consumer information. Then there are the non-banks that are stating or implying that the non-bank entity is FDIC insured or that their product that they're promoting or advertising is

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insured. We've also seen entities implying DI, deposit insurance, will apply if the non-DI fails. And that's not so.

Other types that we've seen are entities that advertise insured products alongside non-insured products on the same consumer facing website pages. This causes confusion. And it also elevates consumer risk and may call into question the safety of deposit insurance. Next slide, please.

As part of the new final rule, the FDIC launched a new consumer portal that the, that's on the FDIC, I think it's called the support and information website. And I think it's up, yes, it's up there.

This portal allows consumers to report potential deposit insurance misreps. They can do it anonymously or they can give us their information, and that will garner a response from us.

Since launching this portal, we have

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submissions of over 300. And indeed, as of last week, in a meeting I was told that the submissions are about ten a day. We have also sent six public cease and desist letters related to potential misrepresentations. And we continue to evaluate the submissions daily. Next slide, please.

And this is just the screen of additional resources of information about deposit insurance that are quite useful. Thank you. If you have any questions, I'm happy to answer.

MR. MILLER: My name is Jonathan Miller. Excuse me. I work in the Division of Depositor and Consumer Protection in Policy and Research. And I'm going to -- is this on? And I'm going to talk a little bit about some work we're doing on official, our official sign and advertising rules and what we're thinking about in terms of updating.

So, and this really follows directly from the misrepresentation discussion that you just heard from Rhonda. I just have to say, by

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the way, you've got us surrounded up --

(Laughter.)

MR. MILLER: So, on February 26, 2020, we published our initial request for information, or RFI, on, requesting comment on modernization of our signage and advertising rules. I think, of course, in March 2020 we had some other events, and people got a little distracted, including us. So we reissued that RFI on April 9, 2021.

Our goal is to gather feedback or was to gather feedback regarding how we might reform our rules to keep pace with how today's banks offer deposit products and services and how consumers connect with banks, including through evolving channels, such as online and, in particular, mobile apps. I'll talk a little bit more about that in a second.

We received 20 comments from trade associations, insured depositories, and others. We also reached out and conducted nine stakeholder meetings with banks, with technology

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service providers, with consumer groups, and others through informal discussions just to gather additional information.

I would say commenters, all the stakeholders that we spoke to universally recognized the need for updating the sign and advertising requirements for the FDIC in response to the changes and industry practices and the increasingly significant role played by digital and mobile banking.

Commenters also indicated that consumers assume that products that are offered through banks are insured and emphasize the role of third parties in offering uninsured products and the importance of enabling consumers to identify and distinguish uninsured from insured products.

This is an important point worth underscoring. We want to help ensure that customers are not confused about what products are insured and what products are not insured.

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And we see customer confusion as a serious potential risk. As you can imagine, this is a problem, the solution to which is becoming more challenging.

Just yesterday we released our 2021 national survey of unbanked and underbanked households, which I commend to you. It's got -- I mean, we do it with the Census -- it's a huge survey, and there's a lot of terrific data in there.

One of the data points particularly worth underscoring in this context is that it shows now that mobile banking is the primary method of account access for the largest number of people. And I'll just give you a sense of that.

In our 2017 survey, 15.1 percent of banked individuals, individuals with bank accounts, said their primary way of accessing their account was mobile. That's 15.1 percent, 2017. It more than doubled to 34 percent in 2019.

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And in the data we released yesterday from 2021, it's now 43.5 percent. So almost half of all banked customers use mobile as their primary access point.

Now, I would be remiss if I didn't also say that even people who use mobile as a primary access point continue to use branches. And that is regardless of race, ethnicity, and even age actually.

I was surprised as a, as somebody in the 65 years or more category, I was surprised to see that even folks in the 24 years old category, almost 60 percent will visit a bank branch at least once a year. So branches still play an important role.

But the really huge jump in mobile as a primary access point really is why we're paying so much attention to how we can take and update our advertising, our official sign and advertising regulations to just a completely new environment.

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The last time we updated these rules was 2006. And, you know, this data for just the four past years indicates what a different world we're living in and why this is so important. So we're considering next steps. And we look forward to a lot more public engagement on this issue. Thank you.

MS. EBERLEY: Questions or comments for Rhonda or Jonathan?

MEMBER JAMES: Thank you very much for the information.

So there's obviously been a proliferation over the last five years or so of neobanks, these fintech companies that are advertising, you know, basically full scale banking services to consumers and even small businesses. Some of them, many of them actually, you know, purport to pursue the unbanked or the underbanked and to use these apps as a way of getting, you know, deepening access.

What's the approach of the FDIC when

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one of those companies comes out and says that they're a bank but they're not really? I mean, you know, is there sort of a bright line, or are you looking to see if someplace buried on their website is some disclosure about the bank that, where the deposits really sit, or, you know, what's the process for those companies that purport to be a bank but aren't?

MS. CAMPBELL: Well, I don't think that there's a process. But I do say that we have resources, and we hope to get out that information to consumers. One of the sources is BankFind, where you can go, any consumer can go and determine whether that is actually an FDIC insured depository institution or whether it's a fintech or whatever it might be. But I don't know if there's an approach.

We get the information about whether a misrepresentation is being made unfortunately. And then at that time, that's when we act, if that helps.

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MEMBER JAMES: It does help. Thank you.

MS. EBERLEY: I might just add that many state chartering authorities have rules about the use of the term bank. And so that will, you'll see that happen first where the state authorities will say you're not licensed as a bank in this state, you may not use that in your name or advertising. But that's separate from the deposit insurance piece.

ACTING CHAIRMAN GRUENBERG: Just to make the point, it is against the law to misrepresent that you're providing FDIC insured deposits if you are not. And if you do, we will take action as we have in a number of cases.

In those instances thus far this year, we've sent letters demanding that the company cease and desist and indicating that if they don't comply with the request, we have additional authority so we can utilize in that regard.

So it is something. We care about

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everything but misrepresentation of FDIC insurance, the FDIC logo, is something we take particularly personally because it goes to the core credibility and confidence in the FDIC which is really the foundation of what we do. When a company engages in misrepresentation, it really undermines the public's confidence in the banking system. And that's really a core fundamental issue for us.

MR. MILLER: Just to address the premise of the question a little bit as well, so you do see a lot of these third-party think tank types talking about service to the unbanked or under-served and so forth.

I think skepticism is the best approach to that. Again, I would commend the survey that was just released yesterday. One of the main reasons that the unbanked rate dropped, and it dropped pretty well and pretty significantly in the last two years from 2019 to 2021 from 5.4 to 4.5 percent -- that's almost two

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million more people with bank accounts. One of the reasons that it did is the emergency payments that they got from the government.

When people have money, they want to go to a bank and put it in a bank because they understand that's where it's the safest and they've got deposit insurance there. And so I still think -- and we at the FDIC take the view that is the very first step on a ladder of economic opportunity so we work very hard to get people into bank accounts, into insured depository institutions. That, to us, is the key to economic inclusion.

ACTING CHAIRMAN GRUENBERG: And it's probably worth that we talked about the third-party relationships, but it's probably worth mentioning that if a bank has a relationship with a third party, the bank does have an obligation to exercise due diligence in regard to that relationship. And if the third party is engaging in some kind of misrepresentation, the bank does

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have an affirmative obligation to monitor that and make us aware of that if it comes to their attention.

That is part of what goes along with having a third-party relationship, particularly if that third party is in some way providing services for the bank and may be in a position to make representations that may or may not be accurate. And it's something we all, I think, have to be very careful about.

MEMBER MAUST: I just wanted to thank the FDIC for taking a pretty active stance in enforcement. I think it's really important to the public confidence comment and objective to make sure that those that do not provide FDIC insurance cannot say that they do.

Particularly, they tend to be the firms that are most at risk of bankruptcy, failure, and those individuals become unsecured creditors to those organizations. And that's completely untenable whether it's consumer

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protection or it's just confidence in the financial system itself which, of course, by extension, it impacts the economy. So, thank you for taking that active stance this year.

MS. EBERLEY: Okay. Thank you Rhonda and Jonathan.

MS. CAMPBELL: Thank you all.

MS. EBERLEY: We will move onto our final segment in this section which is Tom Lyons, Associate Director of Risk Management Policy in the Division of Risk Management Supervision. And Tom is going to discuss the proposed policy statement on prudent commercial real estate loan accommodations and workouts.

Thanks, Tom.

MR. LYONS: Thanks, Doreen.

Thank you everybody. It's good to be here to speak with you today. Appreciate you being here.

As a little bit of background, the banking agencies along with the NCUA and the OTS

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in consultation with the state liaison committee back in 2009 had issued the policy statement on CRE loan workouts. It's provided as a useful resource for both the institutions as well as our examiners when we are understanding risk management and the accounting practices for CRE workouts.

As we were thinking about that from that time to now, there is currently about 98 percent of all institutions have CRE lending and engage in this. It's the largest portfolio type for roughly almost half of those institutions.

In 2020 the pandemic led to stress across a variety of CRE types including hospitality, office, retail, and entertainment sectors. These other sectors -- these and other CRE sectors may be more vulnerable to pressure from rising rates and inflationary pressures.

So a bunch of challenges have arisen during the pandemic including inflation, supply chain imbalances, labor challenges,

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vulnerability to rates, rate increases. These adversely impact the financial condition and repayment capacity for these borrowers.

On August 2nd the FDIC, along with the OCC, the NCUA in consultation with the state regulators for banks and credit unions, published for comment the proposed CRE workout and accommodations statements to address these issues and to update a lot of things since then.

The Federal Reserve wasn't able to join us at that time. They had some challenges because their vice chair was in the process of getting confirmed so they published on September 15th.

The comment period for the FDIC's issuance did expire, or ended, on October 3rd but the Federal Reserve is open until November 14th so still an opportunity to provide comments if you'd like to do so.

So the statement updates and expanse on the 2009 policy statements on CRE workouts

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particularly included a new section on short-term loan accommodations as financial institutions may benefit from a proposed statements inclusion of discussion on the short-term accommodations and workout arrangements that may be applicable to CRE.

There's a lot of statements at the beginning of the pandemic that we had issued to help institutions with understanding and enacting accommodations and modifications in a prudent and safe and sound manner so we brought those principles into this document.

There's also a lot of accounting changes that have happened since 2009 so the document was to update for all those accounting changes and to reflect the changes that are coming along with CECL enactment so those things have also been built into the proposal.

Revisions and additions to the examples. There's a whole host of examples of how examiners will be looking at various

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scenarios and different products, CRE types when it comes to accounting treatment, classification treatment, reporting treatment.

We added three new examples; one for multi-family and how we would be looking at that; for residential construction as well; and income-producing hotels, hospitality. So those are three areas that we built into the examples that were already existing.

So on a new slide there are some key principles that were retained in the 2009. The financial institutions that implement prudent CRE accommodations and workout arrangements after performing a comprehensive review of the borrower's financial condition will not be subject to criticism for engaging in these efforts, even if these arrangements result in modified loans that have weaknesses that they may still meet the adverse classification definitions.

Also, that modified loans to borrowers

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who have the ability to repay their debts according to reasonable terms will not be subject to adverse classification solely because the value of collateral decreases.

In response to the request for comment, we'll go the next slide. Agencies received 19 unique letters and they came from trade associations, from bankers, from state banking associations, from individuals, so across the gamut.

They offer some general observations and general feedback, some very specific feedback for us to include in the examples, and elsewhere within the documents. We really appreciate those kinds of comments. They are very, very helpful for us, very constructive as we move forward.

So a few of the themes that we had identified were related to clarifying the definitions or terms such as comprehensive review and reasonable terms to provide some more granularity and clarity about what we meant in

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the document so we are looking at those.

Also, that examiners should focus more on local market conditions than they do national market conditions when we're looking at these various workouts because most of these that we're looking at are really more on a local level so we are looking at that as well.

Also, there were some concerns about , we talked about in the guidance how examiners may make some adjustments when looking at collateral evaluations based on information that they may have and other conclusions.

The commenters were asking for more transparency and explainability, you know, support when and if that happen so there's a full understanding as conveyed to the institutions when we do that.

So the agencies are gathering back together and reviewing the comments that we've received so far. There is still an opportunity for comments to be placed on the Federal

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Reserve's proposal that's out there which is identical to the banking agencies and we'll be considering all those as we move forward with figuring out exactly what we're going to do in finalizing the guidance.

With that, I'm happy to take any questions that you may have.

MS. EBERLEY: Okay, thank you. Another tool just to help be prepared should the worst come. Thank you, Tom. Appreciate that.

For our last item I'll invite up Anthony Lowe, the FDIC's Ombudsman, to provide an update from his organizational area.

ACTING CHAIRMAN GRUENBERG: Anthony, congratulations on making it to Washington. Glad to see you.

MR. LOWE: It was a journey.

Good afternoon everyone. I want to take a few minutes today just to talk a little bit about the Office of the Ombudsman. Three areas I wanted to address specifically talk a

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little bit about our activity report for 2021.

I also have some comments about the post-examine survey that hopefully you do complete at the end of examinations. And then provide a high-level synopsis of some of the issues and concerns that have been raised by you, by the industry, so far in 2022. Definitely -- hopefully we'll have a few minutes maybe for a couple or so questions.

We can go to the next slide. So back early this spring we did issue -- this is our fourth year of issuing an annual report with regard to the activities of the office. Again, for 2021 it was a very busy year. The majority of our work was done virtually with our regional ombudsman contacting industry representatives using the Teams aspect for the most part.

I will tell you that this year in 2022 we have started with the phase 3 that we're in now. We have started moving back into doing more of our visits onsite, you know, visiting with

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bankers. I think a few of you may be as old as I am and you might remember the original Karate Kid movie where Mr. Miyagi says to Daniel-san, "Look eye. Look eye."

He makes the statement that it's important, I think, sometimes to always be across the table or right in the same room so you can look at other people and try to interpret are there some nuance things that they maybe aren't saying that they want you to be aware of so we have tried to get back to that process.

Go to the next slide, please. So just to give a capsule for 2021, we completed approximately close to 700 meetings for external stakeholders, that being bankers, trade association representatives, other regulators, and even some bank counsel that requested to meet with us.

Again, I did mention that we have began to move back into doing most of our visits onsite. One other thing I think is important to

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mention is that we're trying to grow awareness of the Office of the Ombudsman so that, you know, more institutions are aware of the office and the resources that we do provide because the majority of our staff has tenure with the organization.

They've been examiners. They've been here 25/30 years and they can really offer, I think, some really good advice to institutions if they have questions about examinations, about primary points of contact, decision makers, comments or questions regarding how the dispute process or the appeals process works.

We have been working to make sure the majority of our visits and our contacts with banks are original. There are institutions that we have never visited, or have not had an engagement with, in the last five years.

Those few institutions that we do have repeats it's usually because there has been a disagreement during the course of an examination, or a bank does request that we come and have a

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visit and have a discussion about, you know, some issue that may have come up.

We also had last year close to 200 consultations, info requests, follow-up calls from industry. Some of them were rather routine. Can you tell me who is the assistant regional director or regional director that makes X, Y, Z decision? Again, some of them were somewhat complex asking specifically to walk through the process for considering an appeal of a material supervisory finding.

Go to the next slide. So the post-exam survey, I just want to talk a little bit about this. We hopefully are going to get the survey response rate up a little bit higher than it has been. We have made some progress.

I looked and compared the first quarter of 2021 to the recently completed quarter of June and there's usually differences with regard to the return rates. This is the bankers that do return the post-exam surveys for the

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compliance discipline.

It increased from the first quarter of last year to June of this year from 48 percent to 67 percent return rate. For the risk management, it increased from 41 percent to 52 percent so definitely headed in the right direction.

I always stress, and I know my staff does when we do visitations with institutions, it's extremely important the feedback we get from these post-examinations and surveys. It helps to inform us of issues that there may be a need for more clarity or explanation, or maybe even some training that needs to be done by the driver divisions.

We do report that to Doreen for the risk management and to Mark Pierce and Chris Finnegan for other compliance, and also report to the chairman. It is extremely important that feedback that we do receive from the industry. Again, we hope that we can get those numbers, the response rates, up.

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Just a little bit of recall, the post-examination surveys do include a number of questions that ask about the conduct of the examination. Did you find the information that was provided useful when you received the report back? Was it professional? Is it going to help the institution with regard to identifying specific areas of risk? Again, very important to get that information.

We are -- my office is in the process now of doing some updates and minor changes to some of the questions, to add some questions, or solicit some responses regarding the virtual aspects of the examinations and also to address specifically a couple of the specialty areas that have been embedded in some of the examinations.

Sometime early 2023 we'll launch the new survey and we'll definitely have some information that we'll get out to the industry before that does get launched.

Next slide. So just to touch on some

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of the items, some of the areas, that have been coming up so far in 2022, probably no surprise, from the industry, the reg burden, one of the items I heard mentioned earlier, that I heard mentioned earlier in regard to pre-examination planning. I don't think a day goes by that we have some type of a visitation or conversation with a banker that there isn't, you know, some mention about the pre-examination process and the pre-examination questionnaires that we use.

Again, we do provide that information to risk and to compliance. We get the generic "there's too many regulations for community banks." That comes up every time that we do have a visitation. And the re-presentments issue has been a constant probably for the last six/seven months. I know Chris Finnegan talked about that a little bit earlier so those are some of the areas that do come up from a reg burden.

For the virtual examination in that regard, we have heard fairly consistently, and I

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think this meshes with the comments that Doreen mentioned earlier, that the majority of bankers when we ask that question, they definitely do want us to have a hybrid approach on risk and compliance, but they do also indicate for those certain areas.

BSA, or if you have a material violation, if you're going to cite a fair lending or any major MRBA, those conversations need to be held in person onsite so there can be that back and forth and that engagement. That's what we've been hearing with regard to the virtual examinations.

For training, communication, one thing we've been hearing especially in the last couple of months is a lot of institutions that indicated they are definitely in favor and pleased to see that we have started doing the director colleges again.

You know, having that opportunity at the regional level where we had decision makers,

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senior staff from the regions, that are there to answer questions directly, and to give information about expectations, regulatory expectations, something that may be coming up down the line or if we take a new approach to the way that we review certain items.

Under reg modernization, there's been a lot of comments with regard to CRA, about flood, about cannabis asking us can we do something to endorse the SAFE Act and those type of things. Of course, those things are definitely out of our purview.

Next slide, please. So, again, if you did not get an opportunity to view the report, you can access it through this QR code here, or you can just write me and I can get it back to you. I would definitely like to get feedback from you as to what you liked, what you didn't like.

This report that we just issued back this spring is somewhat more streamlined versus

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the previous reports and it was based on feedback that we got from the industry, that you did want more data points, more high level, so that's what we tried to do. If you do have some additional suggestions, we definitely would like to hear those.

I'll stop there and see if you've got any questions, comments, anything I can try to answer.

MEMBER OSTERBUHR: Anthony, thank you for the work. Thank you for your office and your staff. I've been contacted by the Federal Home Loan Bank of Topeka, a gentleman by the name of Dan Hess.

I was provided a copy of a letter that was provided by several banking associations and the Independent Bankers Association. I'm not familiar with this but they've asked me if I would just ask a question with regards to capital for Federal Home Loan Bank.

It seemed that the Federal Housing

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Finance Agency is using the most up-to-date capital definition, but they want to ensure that it's changed, it hasn't been enhanced in the last 10 years. They are recommending that the agency modify Section 1266.4 so it looks to Tier 1 capital as defined by the FDIC in Part 324.2 in order to help them meet capital issues that may be pending where commercial banks will be with investments and securities. Are you familiar with any of that?

MR. LOWE: I'm quite familiar with it. I know there's some nuance differences between regulatory capital and Federal Home Loan.

Doreen, you may be a little bit better to answer that question.

MEMBER OSTERBUHR: Thank you.

MS. EBERLEY: Sure. So the issue that has been raised is that the Federal Home Loan Bank is prohibited from extending new money by rule. It's prohibited from extending new money to an institution that has negative tangible

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equity capital on a gap basis.

They can continue to extend existing borrowings in 30-day increments but they can't go further unless a federal regulator requests that they do so. So that is the bottom line issue. We have seen the letter that you're referencing that requests that the Federal Housing Finance Agency amend the rule to change the capital requirement.

So I think we're talking -- the approach we're taking is that we're talking to institutions that either have negative tangible equity capital or are on a path to that based on not unrealized losses unavailable for sale securities.

Our conversations with institutions are about what are their strategies for working through this issue. How long do they think this issue is going to last. We had some conversations about that this morning, you know, that folks are looking probably a good year, maybe a couple

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years, to get through this economic cycle, this interest rate cycle.

So what is the institution management's plan and strategy for working through that? You know, we have asked institutions for years, and we talked about this this morning as well, and I appreciated Trey's comments, you know, what may have seemed like an academic exercise when we asked institutions to stress test their balance sheet for 300 or 400 basis-point rate shock, we've been asking institutions to do that for a long time and examiners will always look at it during the examination.

That's why, right? That's why we ask institutions to do that and think about that and think about what does it mean for your contingency funding plan for your liquidity plans. You know, if you're Plan B and your contingency funding plan was a federal home loan bank line that may no longer be available, what

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is your Plan C, right?

What funds are available to the institution, what are your strategies, what are your other funding options? So, we're engaging in those conversations with institutions but the matter you raised is not within our purview.

MEMBER OSTERBUHR: Very good. I literally received this telephone call and letter just before I got out of the bank yesterday so I appreciate that.

MS. EBERLEY: Sure.

MEMBER JOHNSON: And Doreen, I think there's been maybe some misconception about the rules. Maybe not the rules but who can do what. I think a lot of banks were thinking maybe some of the first asks were, well, FHLB, FHFA, was going and telling them, well, go back to your regulator and if you do go negative, you ask them for a letter of approval to continue borrowing from FHLB.

I don't see in any world if I were a

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regulator I wouldn't do that. I think the ask in that letter is to get the two agencies together and find a way to, one thing, the rule consistency, that's one of the ways, or make a waiver during this period of time. We came out of our meeting the other day and that's what I really got out of that.

If you have not been contacted by FHLB if you're a member, you really need to. Most of them have already been contacted, especially in other banks. There's one bank in Illinois that is negative right now. It doesn't sound like there will be any as of the third quarter but we don't know that.

We really need to come up with those plans because there's ways around it. Your bankers will figure it out but you need to know what it is and I really strongly suggest if you haven't already been in contact with them, do that.

MS. EBERLEY: Thank you.

MR. LOWE: Thank you. Appreciate it.

MS. EBERLEY: Okay. All right.

Well, thank you very much.

I will turn it back to you, Acting Chairman Gruenberg, for our closing remarks.

ACTING CHAIRMAN GRUENBERG: Thank you, Doreen. I have to say right on schedule. That's pretty good. I was going to say I feel like I've met you all for the first time today and, the fact is, I have met you all for the first time today.

It was a pleasure. I think it is self-evident the value of holding these meetings in person and we will endeavor to continue to do so because it really does add value, I think.

As I mentioned, I particularly thought this morning's round table discussion with you all was very productive and I want to thank the staff really for skillfully setting up a framework of leading us through a set of questions that really elicited a set of

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thoughtful comments that were really informative to us and perhaps informative to you as well.

As we acknowledged at lunch, but I want to put it on the public record here, we want to express our gratitude to a number of the members of this committee whose terms are expiring and will be leaving the committee but I would like to acknowledge their service:

Betsy Johnson, President and CEO of Solutions Bank, Forreston, Illinois. Bruce Lowry, President and CEO of Ireland Bank in Malad City, Idaho. Neil McCurry, President of Seacoast National Bank in Sarasota, Florida. Gilbert Narvaez, President and Chief Executive Officer of Falcon International Bank in Laredo, Texas.

B. J. Wharton, President and CEO of Yampa Valley Bank, Steamboat Springs, Colorado. And one member of our Committee who could not be here today but I would like to acknowledge her as well, Margaret Oldner, the CEO of Stone Bank in Mountain View, Arkansas.

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Thank you all. We really are very appreciative. The value of this Committee is self-evident, I think. Wonderful to see you all. And for those of you who are going to remain on the Committee, we'll see you next time. Thank you.

(Whereupon, the above-entitled matter went off the record at 2:29 p.m.)