FEDERAL DEPOSIT INSURANCE CORPORATION

+ + + + +

ADVISORY COMMITTEE ON COMMUNITY BANKING

+ + + + +

MEETING

+ + + + +

THURSDAY,
OCTOBER 5, 2023

+ + + + +

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

PRESENT:

THOMAS BATES, President and CEO, Legends Bank Clarksville, Tennessee
MIKE BOCK, CEO, Dairy State Bank, Rice Lake, Wisconsin
TROY CAMPBELL, President and CEO, Altoona First Savings Bank, Altoona, Pennsylvania
ANITA DRENTLAW, President and CEO, New Market Bank, New Market, Minnesota
SUSAN HORTON, President, CEO and Chairman of the Board, Wheatland Bank, Spokane, Washington
HAROLD HORVAT, President, CEO and Chairman of the Board, Centreville Bank, West Warwick, Rhode Island
WARREN HUANG, General Counsel, Amerasia Bank, Flushing, New York

ROBERT JAMES II, Executive Vice President, Carver State Bank, Savannah, Georgia
CINDY KITNER, President and CEO, Jefferson Security Bank, Shepherdstown, West Virginia
TREY MAUST, Executive Chairman, Lewis & Clark Bank, Oregon City, Oregon
DOMINIK MJARTAN, President and CEO, OPTUS Bank, Columbia, South Carolina
ARLEN OSTERBUHR, CEO and Chairman of the Board, Minden Exchange Bank and Trust Company, Minden, Nebraska
APRIL PERRY, CEO and Chairman of the Board, Kentucky Farmers Bank Corporation, Ashland, Kentucky
SHANE PILARSKI, President and CEO, Alliance Bank, Francesville, Indiana
KIM REIGELSBERGER, President, Preferred Bank, Rothville, Missouri
TROY RICHARDS, President and COO, Guaranty Bank & Trust Company, Delhi, Louisiana
LILLOUS ANN SHOEMAKER, President, Magnolia State Bank, Bay Springs, Mississippi

ALSO PRESENT:
MARTIN J. GRUENBERG, Chairman, Federal Deposit Insurance Corporation
TRAVIS HILL, Vice Chairman, Federal Deposit Insurance Corporation

C-O-N-T-E-N-T-S

Introductory Remarks 4

Discussion of Banking Conditions 7

2022 Financial Institution Diversity
Self-Assessments 101

Update from the Minority Depository
Institutions Subcommittee 121

Supervision and Policy Updates 126

Closing Remarks 237

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

(9:07 a.m.)

CHAIRMAN GRUENBERG: It looks like everybody's here and ready to go, so I promise to be brief. I think we've got an excellent agenda planned for today. I think it will be an interesting meeting. And candidly, I think we particularly welcome your feedback on what seems to us to be a pretty uncertain and cloudy economic outlook. And any line of sight you can provide us in terms of what you're seeing in your -- in your communities, I think would be of great interest. Our folks are about to lay out our take on the state of the financial system. You know, if you've read our quarterly banking profiles, you know that we've indicated that the banking industry is proven quite resilient over a pretty challenging period. It remains well capitalized with good credit quality. Liquidity has stabilized and lending has held out. So, there's a lot of positives to say about the

banking industry right now.

It's also fair to say that we have an uncertain economic outlook. We have a high interest rate environment, which I think you're about to tell us is placing some pressures on your net interest margins and earnings. And also creates uncertainty in terms of the performance of the economy, which would have a lot of relevance to us going forward with underlying vulnerabilities that we've been talking about in the QBP, including unrealized losses, on assets held on the balance sheets of banks, concentrations of uninsured deposits, and concentrations of commercial real estate.

So, you put all of that together and that raises a lot of questions in regard to what we may be looking at over the next three to six to twelve months. And I think we'd very much welcome your thoughts in terms of what you're seeing and how you're viewing the outlook. But if I may, let me ask our Vice Chairman, Travis

Hill, if he might want to say a few words.

VICE CHAIRMAN HILL: I'll just second the Chairman's remarks. Look forward to hearing from everyone, hearing feedback about what you're seeing in your communities. And thanks everyone for being here and look forward to the discussion.

CHAIRMAN GRUENBERG: Thank you. And now I'll turn the program over to Nikita Pearson, who's our Deputy for External Affairs and Director of our Office of Minority and Women Inclusion who will serve as the moderator for today.

MS. PEARSON: Thank you very much, Chairman. Before I get started, something I would like to do today, we invited students as a part of our Diversity Equity Inclusion Strategic Plan. Part of our plan includes a section called Community and our work here includes inviting individuals from minority-serving institutions, like Hispanic-serving institutions and

historically Black colleges and universities, to expose them to and invite them to financial services and including them into examining opportunities in banking careers, including regulatory careers.

So, we have a special guest with us today. Her name is Cassia Rodrigues. She's a student with the University of Maryland. Cassia? Yeah. And so, we also invited students from Morgan State University, but you probably saw on the news, unfortunately, those students were unable to attend. There was a mass shooting at Morgan State this week. And we keep them in our thoughts and prayers. But one of the things that FDIC, as a part of our plan, is to make sure that we help bridge the gap with minority-serving institutions in the financial services industry.

Now moving on with our program, we have today, some colleagues of ours to talk about the banking conditions. We have Camille Schmidt from our Division of Risk Management Supervision,

as well as Krishna Patel and Benjamin -- I'm sorry, Benjamin Tikvina from our Division of Insurance and Research who will present on banking conditions.

MS. PATEL: Great, thank you. Thank you for the kind introduction and it's a pleasure to be here. I'm very excited to hear your thoughts on conditions in your banks. Let's begin the presentation. Do we have a way to -- okay, thank you.

CHAIRMAN GRUENBERG: If you want to pull the mic a little closer to you.

MS. PATEL: Yes, thank you. So let me give a brief overview of what we'll talk about. We'll keep our remarks brief. We want to hear -- We want to spend most of the time hearing from you. First, I'll talk -- I'll spend a few minutes talking about economic conditions more broadly just so you'll get a sense for how it might relate to banking conditions. And really, we want to spend most of our time talking about funding and

interest rate risk, as well as credit risk to the extent that, that might be challenging in today's environment.

So, we will have sort of -- Okay, so before I start talking about economic conditions, we will spend most of our time talking about funding risks first and then credit risks. We'll have a short break in between. And you know, Ben will talk about funding risks, Camille will talk about credit risks.

So, economic conditions have been fairly resilient this year. We've been talking about a recession, a slow down for quite some time. But despite those concerns, the economy has held up quite remarkably. Growth was pretty steady this year and is expected to even strengthen this quarter. We had resilience in business investment spending, as well as resilience in the labor market that's helped consumer spending all along.

But you know, as you know, interest

rates have risen over the past year. We've had historically high inflation and so these factors weigh on the economy. They continue to weigh on the economy. And most forecasters expect a recession, maybe not an outright decline in GDP, but sort of a slow, you know, zero -- near zero growth in the coming quarters.

Of course, economic conditions have varied across the country. So, we have here on the map that I've shown here, the dark blue states represent states with relatively stronger GDP growth, the lighter blue states represent ones that were slower. But I think the key thing here to see is that all states grew at least earlier this year, but you know, credit conditions may vary as economic conditions vary in those local geographies.

On the next slide, I want to focus on sort of interest rate developments. So, this -- this has been a key factor influencing economic conditions. You know, interest rates began to

rise sharply in 2022 and they continued to rise. Most recently, the Federal Reserve has kind of reduced the pace of increases. In the most recent meeting, there was even a pause. But the general idea and expectation is for interest rates to continue to increase until next year and potentially even maybe start declining towards the end. But with recent inflation numbers remaining relatively, you know, still higher than the Fed’s target, it's hard to know when the Fed will start to reduce rates.

So, the short-term interest rates have increased dramatically. The longer-term interest rates have also increased. So, in the left-hand -- or the right-hand side, it shows the yield curve that shows interest rates across different maturities. You know, both the short and the long end have increased, but the short end has risen faster. So, the yield curve remains inverted. So, this -- you know, this has posed challenging conditions not only for the economy

as it slowed borrowing and made debt more expensive for consumers and businesses. But it's also posed various challenges for the banks as well.

So let me pass it over to Ben to speak a little bit more about some of those challenges.

MR. TIKVINA: Sure. Good morning, everybody. Thank you, Krishna. So, over the next few slides -- we can move onto the next slide -- I will talk a little bit on the funding and interest rate risks. You'll notice that the chart shows net interest margin spanning over the past 15 years. The black dotted lines represent the industry, followed by the five asset size groups that we report in the quarterly banking profile.

So, for the second consecutive quarter, we had a decline in net interest margin for the banking industry, which is a reflection of higher funding costs. More particularly, cost of borrowings and other non-deposit liabilities

as they're rising at a faster rate than the yields and earning assets. Looking at the various size groups, you'll notice that, that interest margin either remained flat or declined from the previous quarter for all, except for the institutions that are under $100 million.

Community banks continue to report higher net interest margins relative to the banking industry. But at the same time, they had a lower NIM, or net interest margin, both to the prior quarter. And this is mainly due to the increase in cost deposits outpacing the increase in the yield on loans.

Moving onto the next chart where we look at liquid assets and a whole set of funds as a percent of total assets. During the pandemic as bank deposit and liquid assets swelled, the liquid asset ratio rose and the reliance on wholesale deposits declined. However, liquid assets have been decreasing over the past multiple quarters as cash balances, security

portfolios have declined to more normalized levels.

Regarding the Q2, we are seeing a decline in liquid assets. And it's mostly due to pledged securities, which was from prudent liquidity contingency planning and also declining cash and securities. Over the past several quarters, we have seen an increase or more of a reliance on wholesale funds. And more particularly, that has been led by broker deposits and FHLB borrowings.

Moving onto the next slide. So, on this slide and on the gold bar, as you'll notice that the non-deposit liabilities over the past several quarters leading up to the prior quarter have been increasing where they have actually declined for Q2. And that's mostly been due to lower FHLB borrowings. However, for the past fifth consecutive quarter, we have seen a decline in deposits. The decline in deposits for this quarter indicated by the blue line is actually

lower than what we had in the prior quarter in Q1. So, we are seeing continuation of the trend where customers are seeking higher yield -- higher yield. So, in other words, lower earning accounts such as transaction, market deposits, owner-saving accounts declined during the quarter while time deposits increased. As well, we did see a decline in uninsured deposits and an increase in insured deposits.

So that leads me to the next slide. This is more of a slide where we kind of tee up some of the potential discussions for today or for the first part of this presentation. So, I've brought up a lot of interesting topics that touch on the funding and interest rate risk. We've devoted plenty of time for the discussion. And I would like to hear how your bank is being affected by the rising interest rate environment. Also, in order to retain deposits and be competitive, how fast have you raised your deposit rates? As well, I would like to hear

have you seen any significant shift in deposit flows and what concerns you have about funding conditions.

So that being said, I would like to turn -- turn it over to you guys and perhaps maybe you can provide some talking points for us.

MEMBER REIGELSBERGER: I don't mind going first. I think what we have seen, think about the rising interest rates. We were in a very good liquidity position before rates started rising to where our loans deposit ratio was rather low. Now our goal was to raise -- you know, to increase our loan-to-deposit ratio, so we did have excess liquidity going into this. And I feel like maybe that was a God send after all.

But some of our competition has had to raise deposit rates. And guess what that does for us who really don't need the deposits. But we were really hesitant to try to play that competitive rate game, I guess is the best way to

put it. So, we thought well, maybe we just need to monitor the dollars that moves out. So, I call it -- this is my own terms -- excess deposits that our customers have. Maybe not their operating count or not their personal account, but what I want to call excess money.

How much of that is going out? So, I started tracking that, whether it be for a $25,000 CD to our competition, maybe some of it went out to Edward Jones, to Schwab. And those two national firms is where I saw 95 percent of the money going. Now I don't think we could have competed with their rates anyway. We did have some move out to just local banks. But it was really a small amount. But those two and then buying treasuries. We saw several of our customers buying treasuries.

So that has affected, but we feel like we're still in a good position because, you know, obviously if it's what I want to call these excess funds, if we raised our rates -- We did raise

them a little bit, but not much, which on the flip side has allowed us to keep our loan rates not extremely high. And so, as we talk to our customers selling that point of it, even if they're the depositor, they seem to understand oh, well, that you're not trying to gouge anybody by, you know, raising those rates so high on loans because you're not paying a whole lot more than what we had been previously.

So that's kind of worked for us. I know with COVID, we saw deposits increase 25 percent. We don't really want to be there with that excess liquidity because we want to invest it into loans. And then if we need it, you can always raise our rates and get some of that money back. So, we kind of feel like we're maybe in a good spot right now. We're still monitoring any monies that have gone out, but that has really slowed off. Most of it went out in the first quarter, a little bit in the second quarter. And so far in the third quarter, it's been almost

dropped to nothing.

So, we've only seen our deposit accounts slide back about 3 to 4 percent. Nothing compared to 20 percent that we got in 2020. But we feel like at this point, we're in a pretty good position. We do have some of our competitors that have basically -- lending is nil. They've just stopped it. They're trying to hold the deposits they can, but they're loan rates are a lot higher than ours now too. So, we're not in that position, but we have seen our competition do that. And I'm surprised it hadn't brought that many more loans our direction, but you know, time -- you know, time will tell on that. So that's kind of what's going on in Missouri.

MEMBER PILARSKI: I'll just kind of piggyback off that. I know you're from Missouri, correct, so Shane Pilarksi, I'm from Northwest Indiana. And really our scenarios are almost identical. Just so for context, I guess, for Missouri and Indiana, my comments would -- my

comments would really just echo hers. We have experienced loan growth though. Our loan-to-deposit ratio is at 63 percent right now, so we still even have room for more loan growth.

MEMBER HORVAT: I'm Hal Horvat. I'm with Centreville Bank in Rhode Island and our market is pretty much New England. We have a very different story. Our loan-to-deposit ratio is about 100 percent right now and it's the first time it's been up that high historically.

We've been in a growth mode, so we had to increase deposits. We have done that, but we've certainly had to pay for it. And it's the inverted yield curve that's really impacted us significantly because most of our loans are on a five-year basis and our deposits are obviously on a short-term basis. And it's really -- it's really affected our net interest margin.

What we're seeing is most banks in New England, most of our customers are -- our competitors are in the same boat, over 100

percent loan-to-deposit. So, the demand is still there, particularly for commercial real estate. We haven't seen any softening, but a lot of banks are out of the market. They're just not lending, even though they're not publically saying it, it's just the reality is it's not happening.

We on the other hand were strong because we have good liquidity and good capital, but we're very selective. If we can't get deposits with loans, we're not doing it. If we can't get the proper rate, we're not doing it. So, it's a very interesting time because we have great opportunities to pick up some really good customers, but we're passing on a lot as well because of the environment.

MEMBER OSTERBUHR: Good morning. I'm Arlen Osterbuhr. I'm with the Midland States Bank in Midland, Nebraska. Pretty much the same as what the ladies have said here. However, the important thing is to maintain our margins through the time when we were paying higher

interest rates and everyone else was paying a little bit less. We were keeping and maintaining the good customers in our area -- in our market area and picking up good customers as well.

Right now, our liquidity and capital are very strong. Our loan-to-deposit ratio for the first part of the year is about 40 percent. It's now up to about 65 to 70. And generally, through the years, we've maintained around 80 percent loan deposit ratio -- 80 to 85. And so, this has been a change for us running a low loan-to-deposit ratio. However, having a strong capital liquidities position has certainly helped us along the way.

Competitive deposits, we have a lot of financial institutions in the neighboring communities that are within 50 miles from our place and we see a lot of competition. In one community, there's 35 banks and they are way ahead of us in offering deposit rates that are special and also their normal rates. And it's

all over the board. They're either paying really low rates for normal CD, three-month, six--month, 12-month terms. But we've all jumped into the bandwagon with offering specials. And so odd number of months, seven months, 11 months, 15 months, 18 months, and seeing around 5.5 percent in those areas, which is a wide span from the three-month and six-month.

They've become very competitive. However, customers who have been generally very loyal have been shopping rates. And as mentioned before, Edward Jones and other investment companies have been out there and they've taken some of the deposits away as well. But in order to maintain the margins that we have, I don't -- I don't see a real emergency in losing some of those deposits. My concern here is the schools that our community banks are involved with all the time in helping and providing funding to the school to provide quality education to our young people in our communities are also the ones out

there looking at shopping rates. And for that, that's a concern when your local funds are going out of town for those reasons.

Hospitals the same way. Although I see hospitals and nursing homes struggling with the expensive agency staffing and having to maintain. A lot of the money in the nursing homes and the hospitals right now are from stimulus money and/or assistance from the Government, which is fine, and I'd like to see them keep their doors open. But we've seen a lot of those close in Nebraska as well.

So, our competition generally is within the banking system and other investors. And then the fact that our customers are shopping rates and becoming very knowledgeable and demanding on what they'd like to see on their deposit accounts. So, we treat the public funds and the tax money for those taxing entities a little differently. We do try and keep those funds in our -- in our community because they are

tax money.

Current funding conditions, we have had a need for borrowing from the Federal Home Loan Bank and others through this year; however, that's an agricultural situation. It's cyclical at this time of year when it's harvest time, we're generally at a point where we do borrow money and we do have a lot of funds coming into the bank. And it's all based on marketing through the agricultural sector. And so, we'll see more money come in as the end of year and tax season approaches. The situation, the business of farming and providing sales and revenue comes in either at the first of the year or after the first of the year. Thank you.

MEMBER HUANG: So, our situation in -- I'm Warren, Amerasia Bank, is actually very similar to Harold and things happening in Rhode Island. All the banks in our area, the liquidity is strong, but our loan-to-deposit ratios are all at 100 percent or even higher. We broke the 100

percent mark maybe two months ago. And we've been kind of riding that 100 percent right around there.

Most of it -- A lot of it is due to we've probably had 12 to 14 percent deposit runoff in the last 12 months. A lot of it was we didn't want to match our competitors that were offering rates and they were climbing really fast, really high over the last, I would say 12-month period. We've increased our CD rates. They're in the high 4s at this point, but some are offering 5.5. We've even seen 6 for preferred customers at other banks.

And so, it's been a little bit of a drag on the loan side. So, we've actually seen that -- you know, we've adjusted our loan products accordingly where we are doing longer fixed terms to ride out the short term and try to keep the customer fixed once the rates start coming down a little bit. But on the other side, we have customers that we did loans with two or

three years ago and now they're adjustable rates are going up to 9, 10 percent and they're coming back for modifications. So, we also have to factor that in.

The local deposit rates are actually higher now than Federal Home Loan Bank’s five year. So, for us, we're trying to play that margin game a little bit by taking some of the Federal Home Loan Bank’s. So, we would be one of those banks with the goal that we've talked about. So right now, everybody is just trying to see what's the best way to get those -- the liabilities -- to try to match the long term and short term and the margins right there.

MEMBER RICHARDS: Good morning. Troy Richards, Guarantee Bank in Louisiana. And as far as how are we being affected by interest rates, you know, there's positives and there's negatives when it comes to rising interest rates or rate changes in general. The positive aspect is that we're very asset sensitive, so of course

when rates go up, we make more money, so that's always a good thing. But while the re-pricing of our loan portfolio would yield higher rates, the problem can be seen in a potential inability of some of our borrowers to be able to service their debt when their loan is due and come up for renewal. So that's a concern.

Thankfully for us, a good percentage of our commercial loan activity is in one to four family residential category. So much of that increased cost that will be borne by the borrower is going to be passed onto their rental customers. However, there's still a lot of uncertainty about the ultimate outcome of a repriced loan portfolio. And we haven't seen the full effect of that yet. If we knew how high rates will get, how long rates will stay there, it would be helpful, but we don't know that.

CHAIRMAN GRUENBERG: I agree with that.

MEMBER RICHARDS: It would help us in

knowing how to price our assets and our liabilities to mitigate interest rate risk. Of course, nobody knows for certain. We have raised rates, I wouldn't say it's been fast. It's been to be able to keep up with competition. We don't want to fall behind. We have kept our interest rate checking, our money market, and our savings rates relatively low as compared with CD rates because the CD rates is where all the action is right now.

Have we seen a shift in deposit flows? We've got about $320 million in deposits to date. We had about $320 million in deposits a year ago. What we've seen is a $15 million shift from non-interest bearing into interest bearing. So that's where we've seen shift.

What concerns do we have? There's a lot of uncertainty about how much deposit bases are going to shrink. Though ours has remained stable, between inflation, the Fed shrinking its balance sheet, the discontinuing of stimulus

payments. We don't know how much shrinkage is yet to come.

Another of our concerns is that -- is the regulator expectation regarding all of this and our approach to all of this. What is going to be the regulatory expectation regarding uninsured deposits, contingency funding, core versus non-core, which I think needs to be redefined. I don't think core versus non-core is even meaningful in today's world. The definition of that is old. It needs to be updated. It's more of uninsured versus insured or stable versus nonstable. But there's no reason to suggest that a $250 million deposit is any less or more secure than any other deposit because of technology and what we've seen with SVB and Signature and all that.

And so, what's going to be the regulatory expectation? It's one thing to know what's going on in our shops, in our own communities. It's another to try to figure out

what you all are going to expect us to be able to show or to prove or to measure. And you know, one of the concerns that we have is you know, the FIL, that I think came out about uninsured deposits and how we're supposed to reduce uninsured deposits by our public funds.

Our public fund deposits are insured, not by FDIC, but they're collateralized. And so why do we need to report those as uninsured? You all are going to want us to look at can we cover uninsured deposits with cash and our lines? Well, if we have to reduce -- we have to add public funds to our uninsured number, well on the other side, our line at the Federal Home Loan Bank is reduced by the amount of the letter of credit that we have to cover those uninsured deposits. We're getting kind of double whammied with that. So that needs to be looked at.

So those are the concerns that we have is what are the expectations? We can manage our bank. We can manage what's going on with interest

rate risk, but what are the regulatory expectations?

MEMBER HORTON: Thank you. Thanks for those comments. I'm Sue Horton out of Spokane, Washington, Eastern Washington, I run Wheatland Bank. We're about $780 million in total assets. And just to give you some perspective on that, we were a big PPP lender like I think most of you were. So, we went into this environment with about a $250 million investment portfolio. It's about $230 million now, generating about 1.5 percent in yield. So, as you can imagine, that impacts the margin.

Fortunately, we have an Ag portfolio that's tied to Prime that's yielding about 9.25 percent and that's about a third. So, we're fortunate that we have that. And so actually our debt interest margin has expanded, not contracted, but just by a slight amount. But we have decided rather than worrying so much about the loan-to-deposit ratio, with an investment

portfolio like that, that you really don't want to sell and take the losses, it seems like the loan-to-deposit ratio isn't as relative as it used to be because we have this huge investment portfolio.

So, we are using the Fed line and the FHLB line so that we can continue to lend and not have to liquidate investments at material losses. Our duration is less than three years on those investments. We know exactly where those cash flows are coming back. $68 million this year, $84 million next year. And we know dollar per dollar how those advances will be repaid.

So as of today, we've borrowed about $100 million. Our loan growth is 19 percent year over year. Our deposit loss year over year is about 7 percent. Part of that though, I would say is still related to the Ag portfolio. It just depends on when they sell crops, if they're doing it in December or they're carrying it over to January. So, you can't always go year to year.

But we were a little bit slow to start matching rates or exception pricing.

I think like the rest of us, we thought hey, why are we competing for a deposit all the sudden for rate. And so, we're a little delayed on that. And we've used more exception pricing. I mean we make sure our rate prices on deposits are in the hunt, but we sure can't compete with the 5.5 percent CD special, nor do we want to. So, we're relying on exception pricing.

We have just moved $100 million of our investment portfolio into held to maturity. We discussed that with the FDIC to make sure we understood the Call Report, the capital treatment. And really that was just to discontinue so much volatility in our GAAP capital calculation because we have an unrealized AOCI of about $20 million. But again, it's a short-term issue.

So, I would say, you know, interest

rates, yeah, they've hurt all of us. I feel we're a little bit fortunate having that Ag portfolio, but we are getting some pricing competitive pressures on that. Other institutions trying to put floors in and things like that. So definitely saw an increase in cost of funds from 0.03 percent to, you know, closer to 1 percent. And then when you layer in the borrowing cost, it's more like 1.35.

Normally 50 percent of our deposits are non-interest bearing. There's still about 45 or 46 percent non-interest bearing. I don't feel we've lost any relationships, but like the other comments around the table, we saw it going to Edward Jones, you know, U.S. Treasuries, and a lot of the brokerage houses in particular.

We also have a lot of credit unions in our environment. And I think credit unions are having more of a liquidity issue is what it feels like to us. We've heard that, you know, they're not even making new loans until certain loans

repay. So, we're not seeing quite as much competition as we were from credit unions on the loan side. We're seeing more of it on the deposit side, trying to generate more deposits. So anyway, that's what we're seeing in Eastern Washington. Thank you.

MEMBER KITNER: Good morning. I'm Cindy Kitner with Jefferson Security Bank. We're located in the eastern panhandle of West Virginia. As you may recall, we've talked before that the bank is 154 years old, certainly in an older community, but yet, we're experiencing a lot of growth. And that's very common for the eastern panhandle.

The panhandle primarily comprises three counties. And again, if you're familiar at all, there's what looks like a little bit of a thumb that sticks out in that area. That gives us a close proximity to both the D.C. market and also Baltimore. So, we've seen and continue to see continued growth.

For us, we had a lower loan-to-deposit ratio. I apologize, I'm trying to speak to everyone. We did have a lower loan-to-deposit ratio. And for us, that was in the seventies. We did see that come up, but here recently, it has come down. And surprisingly what we've seen is a recent increase in deposits. So, our deposits really stayed stable over the first six months of this year. And with some seasonality and in particular, with some public deposits and other activity, we've seen some recent increases.

In addition to that, with the growth in our market, we continue to open up a good number of new accounts. But we have seen some spending within our current customer base, which is reducing those overall balances. So, we've only seen a slight shift. We have seen a shift from our non-interest deposits to our interest bearing. I would agree with a lot of the comments from this morning. CDs are certainly, you know, the area that everyone has

interest in. There's a lot of competition, both with our local competitors and then with the larger ones as we've discussed.

A couple of other things that I would indicate is we continue to see a lot of growth in residential housing. So, I mentioned before that we have a lot of manufacturing opportunities in our area. And those continue to be enhanced with announcements of even more coming. So, with that, there seems to continue to be somewhat of a housing shortage. We are seeing the larger priced houses stay on the market longer, but we continue to have really strong rental markets and a high demand for those lower cost housing.

So, with that, similar to some of the comments from before with the investment portfolio. We did have a larger investment portfolio going into this economic cycle. And we continue to have concern about the AOCI adjustments. We also have a percentage of our portfolio that is in HTM, which did help to

stabilize. But again, with where we all saw the 10-year go here recently, we know that those impacts are going to continue.

So, what we're trying to really focus on is we want to maintain those relationships and it is -- with all the competition and with this, let's just say interesting economic cycle. We have been more intentional with the loans that seem to fit into our portfolio. We've had a tremendous amount of demand, but we want to be selective in making sure that we're serving the community adequately. And also making sure that the pricing makes sense for us versus what our competitors may be doing. Thank you.

MEMBER BATES: I'm Thomas Bates, Legends Bank in Clarksville, Tennessee. We're just outside of the Nashville area and our market has remained surprisingly strong. I've actually seen a lot of investment from out of state and into the national market right now, which creates issues for us. We stayed fairly heavy in funds

up until about February of this year. What I considered to be a lot of excess-fed funds sold. And we were actually moving deposits off the bank, using ICS one-way sales here in the first quarter. But quickly by the end of the first quarter, that changed. So, we're in a more, what I would call normal market now as far as keeping, you know, a smaller amount of fed funds sold.

Our loan-to-deposit ratio had dipped to about 62 percent during the peak of the deposit growth. We've gotten it back to about 75, which is, you know, getting close to where we like to be in the 80 to 85. We have seen decent loan growth this year. We have shrunk deposits. Half of the deposits were by design. We basically asked them to leave. And you know, we're seeing moderate pressure. I mean obviously we're seeing pressure on the NIM, but we're not seeing as much pressure lately on deposit rates as they were earlier. In probably late second quarter, we saw a peak in deposit pressure and things seemed to

have eased off a little bit.

We are seeing banks apparently cut back because we get looks at deals that we wouldn't normally see. Larger deals than we would normally want to do. So, we realize that the larger banks in the Nashville area have started pulling back on real estate deals. So, you know, that gives us a lot more looks, but not much that we would be interested in. I wouldn't say we've tightened our lending standards. I would just say we don't deviate from them pretty much at all anymore. And so that has helped keep the loan growth in check.

But overall, I think the economy housing is still strong. Larger homes are not moving as quick, but small to mid-range homes are still moving very quickly in our area even with this uptick in mortgage rates. We have seen a lot of shakeup in the mortgage market. One of our largest banks in our town completely shut down their mortgage groups. That was over a 100-

person layoff. And we've seen a couple of others do some shakeups. So that's probably the area that I think we're going to see the most disruption in our part of the world.

MEMBER BOCK: Mike Bock from Dairy State Bank in Rice Lake, Wisconsin. Camille, you and I have had some conversations over the years surrounding public funds. And Wisconsin might have a unique situation, I'm not sure, but the State of Wisconsin itself has an originated investment fund the municipalities can all use to put their short-term dollars into.

The historic investment philosophy has been very, very short. If anybody's been watching the short treasury yield curve lately, those prices have been escalating very rapidly. And municipalities being the good financial managers they are, are watching that. And we have had a number of our municipal deposit dollars transfer out of the bank and head to that state fund. We still have more, we collateralize

and we try to stay in a reasonable realm pricing wise, but if you know what a six-month treasury bill is paying today, you can pretty much tell what the state pool rate is paying at this point in time.

But our history in the smaller communities is we've maintained largely the townships, the counties, the school districts, those types. We've always been very high in public deposits in our bank, so this has been a big pressure point on our funding costs because, you know, we are low loan deposit. We have the opportunity to let those run off. But as people know, when you're talking about municipal deposits, a runoff doesn't mean $200,000, it means multiple millions generally when that starts going. So, it's not a practice you want to get into. I'm just saying well, there's another $5 million that's going to go out the door and you just kind of, you burn your powder pretty fast.

The other thing that we're noticing, while you hear interest rates are going up, real estate is being pressured. We are in a part of the state that there's a lot of lake properties and second homes. And while there's not as much residential lending as we saw multiple years ago, there is still lake property that's changing hands. And with the somewhat recent changes in the federal agency's pricing for second home mortgages, I don't know if anybody's following that, but it's become extremely expensive for a borrower to get a second home mortgage. And those lake properties qualify for most of those programs. They are opting not to go to the secondary market, not to go to the agency programs, but are opting instead to keep their loans in house portfolio loans.

With interest rates up, the fees that they have to pay, the costs that they absorb, they're just going to say we're going to park it in the bank for a while. We're going to let rates

come down and we'll refinance at a later date. Even with the higher fees with better rates, they're willing to do that.

So, at a time when we would say your residential mortgage shouldn't be that active, we are having floods of applications, but we have enough applications that it's multiple millions of dollars of applications we're talking about on a weekly basis. And it's because people are opting out of the agency programs based on some of the changes and the pricing that took place largely in the second home mortgage scenario.

So, interesting caveat there, but it's a little bit where we're at and a lot of these second homes are not owned by local people. We're about 100 miles from the Minneapolis/St. Paul market. These are second homes for those people. So compared to market pricing in the Minneapolis/St. Paul area to where we are, even though the locals think our homes have gotten somewhat expensive, it's still a pretty good deal

to those folks that buy a second home and be just a two-hour drive away to a lake property.

So, we're getting kind of mixed reviews, you know, not a lot of home activity, but it's the second homes. And they're very good applications, very good credit situations, so we're happy to do those. But we have municipal deposits in one hand and trying to balance keeping it in. We've got some residential stuff on the other hand that we're looking to keep funding.

And amazingly, in spite of the prices, the numbers of buys and sells taking place between businesses continues to amaze me. I would have thought some of these business transactions would maybe slowed down with interest rates going up, that has not been the case. Good business operators that have been in the business for long term have been through 7 and 8 percent interest rates before. They are not shocked by 8 percent interest rates.

When you talk to somebody that's 30 years of age or less and you say 8 percent, they think you're from another planet. But if somebody's been around the block a few times and they're 60, 65 years old and they're looking at a business transaction and mention 8 percent number, they run their numbers at 8 percent. They don't panic at that. And if it's still economically worthwhile, we've got customers making business acquisitions right now, which in some respects is surprising because it's still happening. Not tons of it, but enough that it's meaningful for us as a community bank.

MEMBER MJARTAN: Good morning. So, I'm Dominik Mjartan. I'm with OPTUS Bank. And I was reflecting just listening to the great feedback, which I've really appreciated and shared most of the experiences with groups in this room. And I think two years ago, we probably had spent maybe two minutes on liquidity and interest rate risk. And now we've been talking

for a significant amount of time. And also two years ago, I couldn't tell you what our total deposits were or total assets were, but every morning, the first email I pull up is, you know, what is our liquidity position?

And literally our Board and our management team monitors our liquidity daily. So, I can tell you as of this morning, we're at $483,151,402. Right? And we were about $400 million at the beginning of the year. So, we took a little different position as we decided that this interest rate environment given the mission of the bank, to serve a high potential, underestimated communities would be a great chance to build new relationships.

We see customers migrating. Customers are aware of the rates and we see them migrating and looking for opportunities. And our position has been let's build those relationships, even if it's a little more expensive for us. And it's paid dividends for us nicely.

Also, our primary focus is on, of course, monitoring NIM just like everyone else does. But we want to see steady growth and core stable, nonvolatile interest income. And so, the decision we made is how do we make sure that we're generating those relationships? So, if the cost of that relationship on the deposit side is 4 percent, we can then generate a very strong quality asset that's yielding 8 percent and we decided we're going to lean into that. And it's working for us. And really reflecting on the risk and the questions there.

Clearly, it's painful when we've taken a longer view. So, we've all been through these cycles before. And so, what we're really focused on is relationship banking. And that's paid huge dividends for us. We negotiated most of the large deposits one on one. We have that relationship. Since the beginning of the year, like I mentioned, we've grown almost $90 million in assets on a $400 million base. And most of the

relationships we have with us stayed. We lost no relationships post SVB.

We definitely had to pay up. So, we're starting to see that interest expense really balloon up, but we're also starting see the yield and earning assets go up almost in sync with it. So that's very consistent with everyone in the room is discussing one concern we do have. And I really appreciate Troy mentioning it, is some of the definitions and treatment of reciprocal deposits or broker deposits of public funds, the core and non-core deposit definitions. I do think they're outdated in today's environment.

Those definitions are certainly not matching the environment and the behavior of our customers that we've seen. And just thinking about how many of the SVB deposits would have been classified as core. And look what happened. Conversely, we have a lot of large depositors that have been with us for five years. Through

all the interest rate environments, they have not migrated out. They definitely ask for a rate bump, but before they move the money, they call us. And I think that's the value of community bank relationship banking model.

MEMBER JAMES: I'll lean in. Robert James II, Carver State Bank in Savannah. But I also --

CHAIRMAN GRUENBERG: Robert, you might try to pull the mic a little closer to you.

MEMBER JAMES: All right. I'll try to lean in as well. So, Carver State Bank in Savannah, Georgia. But we also are part of a multi-bank holding company. So, we're unique. We have Carver in Savannah, but we also have Alamerica Bank in Birmingham, Alabama. And the situations at those institutions are pretty different.

So, at Carver in Savannah, we're running a very low loan-to-deposit ratio. We've really focused on increasing liquidity over the

last, you know, six months. And so, we're at about 60 percent loan-to-deposit ratio. Tier one capital is at 13 percent tier one capital. And we actually just added some capital too. That was as of the second quarter. And so now we're probably closer to 15 percent tier one. So, we were actually quite underleveraged.

At the bank in Alabama, we're at about 85 percent loan-to-deposit ratio. And we -- I really think that Troy's comments about the definitions around core and brokered deposits, I think are very outdated and need to change. We are -- At the bank in Alabama, we're also quite underleveraged. We're over 20 percent tier 1 capital. That's the institution that we just acquired. And so, we've recapitalized the bank.

We really need to add deposits, but we're kind of in a -- in a catch 22. The bank serve a very low income, I like Dom's term, high potential, under-estimated community. I'm going to start using that, Dom. But the bottom line is

the case is not in that community. And so I'm not going to be able to go to the community and get the $20 million in deposits that I need in order to get that bank back profitable.

And so, the capital that we've injected into the bank, every month, it's being eaten away. And frankly, we're going to need some help from our partners at FDIC in order to be able to go and do the reciprocal kind of deposits with the large corporations and larger investors who are really interested in our mission and interested in helping us to serve this, you know, high potential community, but feel like they need to have reciprocal deposit insurance in order to do that. And I don't -- I don't know if there's really another logical way for us to go and increase the size of that institution so that we can get it back profitable and get it back making money. We've changed the management team. We've done all the things that we've got to do and now we need some assistance.

I do think that we are -- we were very late to see large depositors asking for additional rate increases, but it's finally hit us. And so, we're starting to see those larger depositors at both institutions asking for rate increases, whether they're public institutions, so the public funds -- public depositors are asking for rate increases, as well as the larger corporate entities that are depositors are asking for rate increases.

We're very focused on making sure that the ones that we're paying up to, we're really focused on making sure that there's a value-add relationship. And it's not just a very transactional kind of relationship. And so again, it's about the stability of that deposit and the relationship that we're building. The commitment from those depositors to keep that money working in these communities.

And so, we're doing things like reporting out on impact, helping them understand

what's happening with their money, you know, what's the intensity of our lending into the communities that they care about. And that is helping us to create and build these long-term relationships with deposits that otherwise might be regulatorily considered to be brokered or in other ways hot.

But if, you know, we could go and put ads in the paper in Birmingham and go and buy deposits, the proverbial paper. No one reads the paper anymore, but you know what I mean. So, we could put ads on the internet, and we could offer rates and we could get local deposits. But those local deposits would be much hotter than a corporation that puts in over $250,000 deposit, but is committed to the mission of our institution. And I think that's the, you know, that's one aspect of how I think these definitions really need to be looked at because the situation and the customer behavior is just very, very different.

And the reasons that customers want to bank with community banks are frankly about the relationships that they're building and about the impact that they're having in the community. And it's not really about, you know, whether they happen to live two blocks away from your institution.

MEMBER PERRY: April Perry with Kentucky Farmer's Bank in Ashland, Kentucky, Northeast Kentucky. And I think the biggest shift has been with the consumer. You know, when interest rates were low, they were happy to let their money just sit in a non-interest bearing account. But as interest rates have risen and also technology has allowed them to explore other avenues for their -- for their cash, the money is -- they're looking at all their opportunities. You know, how can I earn money on my cash?

So, looking at the brokerage accounts, looking at buying treasuries, and then also the credit unions are a huge competition in our area.

Credit unions have really expanded their reach. They are really acting more like a bank, except for the fact that they don't pay taxes, which I think really needs to be explored because you know, that's a very unfair advantage that they have over banks. I think if they're going to act like a bank, they should, you know, pay like a bank.

So, we have people that, you know, our customers that even though we have great relationships and we're very much, you know, concerned with having a relationship with our customers, not being a transactional -- having transactional customers having relationships with these customers. They are exploring their options and they should.

So, you know, we are paying more for our deposits. And of course, that hurts net interest margin. But I think it's interesting, we went into this rising rate environment expecting rates to eventually rise. And so, we

were heavy in cash, and we had, you know, positioned our balance sheet to be ready for it. And that's been a really good thing.

But now I feel like even though we've always managed our balance sheet, I feel like we're really managing our balance sheet now. You know, we're looking at the numbers on a daily basis and looking at our cash position on a daily basis. And making, you know, sure that everything is how it should be.

But the biggest change has been with the consumer. Looking for a better rate and also going longer with their money. Not putting it into short-term investments or deposit products, but going longer with the CDs.

MS. PEARSON: So, we'll take a 15-minute break now and we'll return at 10:20. Thank you.

CHAIRMAN GRUENBERG: That was a terrific discussion by the way. Thank you.

(Whereupon, the above-entitled matter

went off the record at 10:04 a.m. and resumed at 10:21 a.m.)

MS. PEARSON: Welcome back, everyone. We will get back to our credit discussion, so I will turn it back over to Camille, Krishna, and Benjamin.

MS. SCHMIDT: Thank you, Nikita. I'm going to start today's credit risk discussion with a look at consumer lending. You can see the chart that we posted. Total consumer lending by both banks and non-banks has grown consistently since second quarter of 2020. Auto loans, credit card balances, and other consumer loans have grown nearly 17 percent since the pandemic.

In recent quarters, credit card balances and other consumer loans have grown at a very fast face. We've seen them rise 16 and 12 percent in the past year, respectively. So, as we head into fall, consumer spending, some even labeled -- I've heard it called "revenge spending" with the source of economic strength

during the summer. We saw Americans splurge on international travel. They went to Taylor Swift concerts --

MS. PEARSON: And Beyonce.

MS. SCHMIDT: -- and Beyonce. I usually say that too. And other, you know, they went to a lot of experiences that they had missed during the pandemic. Consumer spending rose 0.8 percent in July and that was the strongest monthly spending gain since January.

However, I'm talking about consumer lending today first, because I feel like discretionary spending is often the first to be cut when budgets come under pressure. Strength and leisure spending did level off toward the end of August according to the Federal Reserve's Beige Book report. And it's really uncertain how consumer spending will shape up in the coming months. But several economists are expecting it to moderate. You even heard Krisha talk about a possible recession coming up.

So, Americans are facing some obstacles. We've got student loan repayment starting back up, although you probably noticed there was an announcement of a $9 billion forgiveness, billion dollar forgiveness program yesterday. Growing debt service or the debt-to-income ratios, shrinking savings accounts, and we earlier talked about how banks are -- some banks may be tightening their credit standards. We'll talk more about that. But those are all obstacles for the consumer.

So far, the delinquency rates of institutions with material exposure to consumer loans remains manageable, but we have seen them start to tick up. Housing is not included on this chart, but I do know some of you specialize in residential lending. The residential market continues to deal with high interest rates that have led to low supply and reduced affordability. Nationally home price appreciation has slowed this year, but I'm really interested to hear what

you're seeing in all of your specific markets.

On the next page, I'm going to shift to commercial real estate, which we discussed in depth when we all met here in June for the June Advisory Committee meeting. But this chart considers data based on expiring office leases for the next ten years. And it shows that at least seven metros in the U.S. have a sizeable share of their metros office leases expiring this year and next year. The Atlanta market has the largest share at over 40 percent. And the Dallas market is just behind them with just under 40 percent.

I think the big office buildings in large U.S. cities are the most at-risk from turmoil in the commercial real estate market. And this is according to several of the CRE research services that we subscribe to. There are signs that smaller offices and suburbs, as well as newer buildings and central business districts could be more insulated from the

stress. And this also ties to anecdotal reports from examiners and case managers who report more often seeing community banks making office loans on buildings and suburbs and on buildings like that are lower than five stories. Some of you are nodding your heads, so you can expand on that soon.

Soft data from the field also indicates that community banks have more exposure to the multi-family and retail sectors than to the office sector. At least those that we've been surveying. As we've been saying with rising interest rates, reduced cash flows, lower property values, and tightening credit conditions, office loans and really all CRE loans coming due in the near term may face some struggles with refinancing.

Then I'll just end on the next slide. This is the Fed's Senior Loan Officer survey. And it matches data that we've gathered from examiners and case managers that confirm that

banks are generally tightening their lending standards. I would say that the information that I've obtained from our field is maybe a little less severe than this. They just start saying some slight tightening. But they're telling me that they report seeing tightening most frequently in the form of loan-to-value and debt service coverage ratio requirements.

So that was kind of short and sweet, but I'm interested to hear your perspectives about loan growth, lending standards at your institutions and among the competition, and just overall lending concerns that you might have in your respective areas.

MEMBER SHOEMAKER: Lillous Ann Shoemaker, Magnolia State Bank. We maintain 80 percent loan-to-deposit ratio and that's kind of how we operate anywhere between 80 and 90 percent. We've definitely seen a slowdown in the housing sector market due to the higher mortgage rates. Demand for our loans is healthy across

all sectors. We've experienced approximately 8 percent loan growth this year.

Deposits are strong. Our growth in commercial and residential real estate has been strong because we had a lot of out of state people moving to Mississippi. We've got a popular HGTV show that has attributed to that greatly. You may have heard of it. Commercial and real estate has experienced double digit percentage increase in market values because of that. So far, so good. We're happy with our deposits.

We've experienced a lot of the competition, but we've been able to maintain about a 2 percent deposit growth over the year to year. And so, we're concerned about the economy, but so far, it's stable in Mississippi.

MEMBER DRENTLAW: Hi. Anita Drentlaw from New Market Bank, which is in the south metro, the Minneapolis/St. Paul area -- metro area, Lakeville, Elko New Market and Prior Lake. We've actually started to really see a lack of demand

for loans. The higher interest rates and higher prices for equipment, lake employment, just the wage increases that people have had to pay their workers, I think has, you know, had an impact on their income statement and their ability to feel like they want to borrow money at a higher rate. I do think that there have been banks in our area that have tightened lending standards. We have always had fairly tight lending standards. Our loan-to-deposit ratio is around 60, 65 percent. We've been trying to grow that for several years. And I think sometimes maybe we're too conservative honestly. We could probably take a little more risk. But having lived through the Great Recession, I think we're a little gun shy honestly. And so, our credit standards have always been fairly high.

I think we tend to focus more on debt service coverage, rather than loan-to-value since their ability to repay is really better than wanting to take back a piece of property. We

have a large commercial real estate portfolio, but most of ours is really owner occupied or maybe, you know, majority owner occupied. They might have a portion of their building that they rent out. But we tend to lend now to people who their businesses is what's repaying that loan.

So, I noticed Minneapolis was on the list of large office spaces being re-priced. And I think, you know, that's going to affect probably a lot of the larger institutions because really our competitors, the community banks that are in our area don't have a lot of that retail or that office space. I do think it will be an issue for our economy though because there's safety issues in Minneapolis. And so, I do think a lot of businesses have moved out of the downtown area towards the suburbs.

Yeah, I don't -- In housing, there is a large shortage of affordable housing in our area, so that has -- we have a large mortgage department and that volume has decreased

significantly this year. A lot of it is due to higher interest rates, but a lot of it is due to a shortage of inventory for one to four family homes that are affordable in the area.

MEMBER PERRY: I'm April Perry with Kentucky Farmers Bank. And being from Appalachia, I think that we have a lot of people that live paycheck to paycheck. And so, they don't tend to have a lot of savings. So, you know, we've always been a bank that lends to people when something happens. You know, their washer breaks, they need to borrow money to buy a new washing machine. You know, so I guess I'm seeing a little bit of a shift.

You know, our loan demand is still really strong, but I'm seeing a little bit of a shift in the types of loans we're making. So we're making a lot more short-term loans, installment loans just to be able to -- for these people to be able to live. Making single pay loans to get them over a hump that maybe they're

going through because of the rising cost.

Also seeing us make more exceptions in our auto lending because people are having to pay a premium for their automobiles. So, the traditional loan value for the automobile that they're wanting to buy, it leaves such a gap that they can't afford that. So, you know, we're making exceptions so that they can actually buy their automobiles, so they can keep going to work.

So that's a -- I think that, that's a shift in our -- in our lending. In a sense, it's good for us because these are higher price loans. So that helps with our net interest margin. But it concerns me for our consumers because, you know, in times like this I feel like the people that least can afford it are going to struggle that much more.

One of the areas I guess I'm most concerned about -- well, two areas is our construction loans. I think I brought this up at

the last meeting that, you know, people that started building a house thinking that their rate was going to go down when they went to permanent financing are now finding that wow, my rate is going up. And it's not just going up a little bit, it's going up a lot. So, this dream home I've been building, am I going to be able to afford to keep it and be able to afford the permanent financing?

So that's something that we've really been looking at. We've been looking at each one of our construction loans and running the numbers to make sure that our clients are not going to find themselves in just a terrible situation when their dream home is complete.

And the same way with our commercial loans. So, you know, a lot of those loans, they will re-price. And when they re-price, our businesses, their interest cost is going up tremendously. So, we're really looking at that and we're trying to be proactive and reach out to

business customers and say, you know, I don't know if you realize this or not, but due to your loan terms, you know, your interest rate is going up to this. And you know, this means you're going to be paying this much more in interest cost.

And even though I know a lot of those businesses could probably afford that, these are great clients. They're, you know, people we've developed relationships with. So, we're trying to be proactive in, you know, trying to work out a solution that is a win-win for everyone. We want to make sure that they don't feel like they're being gouged with a rate that -- I mean they agreed to it, but they never dreamed that the rate that their loan is going to re-price at is what they would be paying.

And I'm finding that our commercial, you know, our business centers are thrilled when we reach out to them and we talk to them about, you know, this is what your loan could look like. But hey, let's see what we can do to make sure

that this is affordable for you, allows you to still be successful. But you know, it's a competitive rate. So, I'm hoping that by doing that, you know, we will cement those relationships and we will be able to help these people for years to come because that's what we want. We want the relationship.

MEMBER REIGELSBERGER: This is Kim and I'm from Northern Missouri and we think about our credit risk. We've got five locations, one's in the metro Kansas City area and four in rural -- when I say rural, the office I work in has less than 99 people. We have one that's got 200 people and one office -- one office has got 4,500 and one's got about 1,200. So, we are rural.

Now speaking about the rural area, we're agriculture. Crops is corn and soybeans and cattle. I actually live on a farm. My husband and I farm. We raise cattle. Let me tell you, this year it's the drought. This is year two for us not getting rain. If we get rain,

it's very, very reduced amounts. So, if you're thinking about, like we raise cows and we have a herd. We raise baby calves. Pond levels are so low. Fortunately, right now, we still have several ponds on our farm, but what are you going to do? You're going to have to sell cattle. You're going to have to sell them because you don't have the water.

Second, when it's drought, we depend on the hay that we put up to feed these cows because grain is really too expensive. You come and maybe supplement a little bit of grain. I'm going to give you an example. One acre of hay ground should give you about four -- when I say big bales, these are the 5-foot tall bales. They should give you about four. That's a good year. You're doing good.

This year we were lucky to get one bale off of it. You can't feed your herd if your crop is, you know, 1/4 of what it should be or I guess -- yeah, went down 3/4. So, it's been a

big challenge just personally. We've had to sell some heads of cattle. So fortunately, the USDA released what we call CRP ground, which is Conservation Reserve Program ground. This is ground that's been set aside for whatever reason, highly erodible or something.

It's not the best hay ground because usually you've got some weeds, you've got some shrubs, some woody. But when you're desperate, you're going to put that up for hay and you're going to sell it. Generally, in a good year, those bales of hay will bring $30 a bale. The CRP hay this year is bringing 75 or so bales, which is not -- like I said, not prime. It's not the best for your herd. But if you've got good hay, you're bringing in $120 a bale, which is ouch. That's really significant.

So that's what we're kind of seeing. The crops so far, we're just getting into harvest. We're about halfway through on corn. Because of this drought and not having enough

rain, we're seeing yields about 3/4 of what they should be. It's not terrible. It's not a disaster. It's going to have to be managing their operation a little more closely. Of course with crop insurance now, that kind of helps that if you're a grain operator. But that's kind of what we're seeing as far as agriculture. We feel like that is something to keep our eyes open for.

As far as housing, usually when somebody in the rural builds a home, that's their home for life. You don't see a whole lot of turnover. But the building of homes has not slowed down. The price has gone up and obviously interest rates if they're having to borrow. I'm shocked that we haven't seen more of a slowdown in that.

One of our local contractors, again these are small business owners, he's got ten people in line -- now you're probably talking three or four years out. Now a lot can happen in those three or four years. We have another small

contractor -- and these are firms, they probably have maybe a five-man crew. They're just small. They build nice homes. They are a couple years out.

So, I'm surprised that, that is still moving forward because the price of home after COVID with the supply chain issues, we haven't seen a whole lot of that come back. I mean it's still expensive. You know, a 2,020 -- I'll say 2,200 square foot home, not large, about $325,000 to $340,000. So that's something to really think about if you're going to -- in this environment.

So, we don't really have any CRE loans. We have a few small businesses, owner-occupied like you said, but their businesses are fine. You know, whether that be, you know, diesel mechanic, whether it be anything along those lines that has to do with agriculture. We're not really seeing a slowdown on those. Those are really staying busy. We're not really concerned about that piece of it. It's nothing that's being

rented out at this time. But that's -- that's kind of what we're seeing.

MEMBER HORVAT: Hal Horvat from Centreville in Southern New England. Our market is Rhode Island, Connecticut, and Massachusetts. We're kind of a broken record when it comes to housing. Low inventory, houses sell very quickly and the prices keep going up. We expected that to level off at some point and it just hasn't happened. It continues to increase. Real problem with affordable housing, it's going to be a problem if we do head into a recession. Vacancy rates on apartments are almost nonexistent and those rates continue to go up.

On the commercial side, the only thing we're seeing soften is the downtown office market. We're not seeing it on suburban as you mentioned. We do have a number of suburban projects and there's a little bit of a flight out to the suburbs and particularly in the Boston area. But the office markets are definitely

seeing some softening as rents come up or as leases come up.

Lending standings haven't really changed. I mean we've continued on the credit side. The credit has been -- we haven't seen that from our competitors either. The only thing that has changed is pricing. We have to get additional pricing and we have to get deposits. But by and large, credit has been really strong.

MEMBER RICHARDS: Troy Richards, Guarantee Bank in Louisiana. For us, consumer borrowing for real estate has slowed down dramatically. Refinances have all but gone away. I think we've probably all seen that. I know my mortgage is at 2.2 percent. I told my wife don't get any ideas about moving. It's not going to happen.

Commercial borrowing for us has remained relatively strong. Our loan portfolio has actually grown some over the past 12 months, even with some tightening of underwriting. It's

probably attributable to the degree on the fact that inflation and interest rates are up, more people are renting, rather than buying. And much of our commercial loan activity is in the one to four family residential property business.

We've seen an increase in past dues, which I know a director once that said if your past dues are more than 2 percent, boy, you're turning down too many loans. And so, he would be happy right now. We've seen an increase in personal bankruptcies. I've been in my 38th year now at the bank. And we've never had as many suits filed as we do right now. Which you know, we're a secured lender, so we're going to get back the properties, but we all know what happens when they're bank-owned properties, pennies on the dollar. You know, so we're trying to manage that risk.

We've also seen an increase in overdrafts. Chris is not here this morning, so I'm not going to bring up my comments about

overdrafts. You all know how I feel about NSF and overdraft fees. It's costing us about $2,400 a month right now, not charging on representments. So that's an employee basically. But anyway, I'll leave that alone.

We have tightened up our lending standards somewhat. Tightening up of our debt service coverage ratio is something that we've really tried to focus on factoring in potential large increases in hazard insurance and flood insurance. I think I commented last time, in our part of the world, if we have one named storm this year, it could be disastrous for Louisiana, for Mississippi, and some of the coastal states. Hazard insurance premiums have skyrocketed.

Deductibles are through the roof. Pardon the pun. Because I know for my church, our deductible went from $2,500 to $25,000. And we've seen some of our commercial customers who have expressed interest in self-insuring. And so, you know, how does that factor into your

underwriting if they're going to do that? So, there's a lot of uncertainty right now in the insurance markets, both hazard and flood. But we have tightened up our credit standards from that standpoint.

You know, we were in Washington last year and heard FEMA very proudly say that, well, it's only going to be a potential 18 percent increase in flood insurance premiums over the next five years. Country boy math said that's almost 100 percent in five years. And so, if you're doing a loan and you're pricing it for five years, are they going to be able to afford the flood insurance premiums if that's the case three years down the line? Big unknowns right now is what's going to happen in the insurance market. So, that's what's happening with us.

MEMBER BOCK: One of the portfolios that I have, maybe not so much concern right now, but I do have a concern three to five years from now, is the senior housing and assisted living.

We are in largely an older population market, a lot of retired folks. Those are the demand. There's going to be a demand. Developers see that demand, so they are starting to build projects. There's already been projects built.

They're already facing the first challenge is the staffing. They can't staff the current housing projects to the level that they need to, to take them up to 100 percent occupancy. So, there's already a challenge starting to pop up on them, but there's still others being developed. So, if more units come on board, if the current ones can't get the staffing they need, the new ones can't get opened. And those are the higher cost -- there's going to be higher room rates. They're going to be the last ones to be occupied.

In the general demographics of this country are we are not getting younger. There is currently a group of folks that have hit the retirement world and starting to fill those units

that I don't know what five to ten years might look like when that demographic starts passing away and we have all these units built up. Again, it's maybe not a concern today, but maybe a canary in a coal mine situation that let's watch out for the delinquent demographics that are going to challenge this whole segment of our financing world.

And just the ability to attract people to staff those facilities. It's a hard job and they are not well paid in most cases. I know the State of Wisconsin is right now making some serious effort to try to get some assistance for those types of facilities so that they can pay their staff better. But the general economics are already being challenged and some of these other things that are going to come down the road with more new units opening. There's going to be more demand for the staff. There's going to be more overhead.

And demographics are we are going to

all pass away. And in our area of the world, that's going to be five to ten years from now. I think there's going to be a lot of empty units that are not going to be that far into the project, that they're going to have a lot of big equity that they can fall back on. I hope it never happens, but it's one of those areas that I see some concerns in our area.

MS. SCHMIDT: We've seen that -- We've seen examiners comment on that, sorry, in several exams or surveys or things that we do to collect data. There's real concerns. And I thought it was maybe just an anomaly in our set, but since you've said that, I just wanted to say we are seeing that a lot too. And I've also seen comments about bankers proactively talking to borrowers before they have to refinance. So, when you mentioned that, that is also something that I'm hearing.

MEMBER HORTON: I'll lean in as you say. Again, Spokane, Washington, Eastern

Washington environment. We're primarily a commercial and ag bank, as well as residential lending. But we sell most of those mortgages on the secondary market.

Just getting a report from my chief credit officer before coming here, you know, first of all back up our asset quality. Like all of yours, I'm sure has been excellent. We have zero nonaccruals. You know, we have zero net loan losses over the past decade. So, we're a pretty conservative bank. We have tightened our credit policies just a little bit in some of the, you know, non-owner occupied CRE space with a higher debt service coverage ratio with a lower loan to value, et cetera.

But what we're seeing is that our Ag producers are experiencing reduction in profits. In 2023, we're just seeing the beginning of that. And you know, the livestock I think is one exception in our area, but primarily in the wheat crops and the hay crops. And we're seeing if

they held on to their crop from the prior year. They have a higher level of inventory and now a lot lower prices. So that's impacting their profitability here in 2023.

Of course, they rely a little bit on crop insurance, but the crop insurance is also down over prior years. And you know, the crop insurance helps, but what they really need is a crop, not the crop insurance. Of course, higher fuel prices are impacting this. You know, everything from, I mean all of the input costs. Like you mentioned, equipment costs, fuel, insurance, and of course interest expense. So that's kind of what we're seeing on the ag side. Most of our ag producers have good strong secondary sources of real estate that's unencumbered that we can kind of take to shore them up for a year or two. And we tend to do that. We work with our customers throughout the process.

On the commercial side, we're really

not seeing any softening or problems there. Of course, we don't lend into the office market. What we're seeing was a little different than what I heard from some of you. Just recently we are seeing a softening in some of the home values, as well as the rental market in terms of prices coming down on apartments, duplexes, multi-family. And then values of the homes coming down as well. So that's what we're seeing out in our area. And like I mentioned, we're seeing a lot of competition still on loans, but not as much from the credit unions. So just a few comments. Thank you.

MEMBER SHOEMAKER: We're adhering to our loan policy. However, like liquidity that we're managing daily, we're monitoring our concentration levels of commercial and residential real estate and stressing them regularly. We're also stressing income-producing properties and ability to repay, not only for our customer portfolio, but for our entire customer

base, which has been very helpful. So those are two things that we're being very active. And also, as April mentioned, reaching out to our commercial customers and making them aware of upcoming maturities.

MEMBER DRENTLAW: I'll add to that. We for several years have done a lot of like stress testing on our HELOC portfolio. And I do think as interest rates, if they stay high or continue to go higher, that could be a portfolio across our area or maybe across the United States that could start to have problems once -- usually it's the auto loans or credit cards first. But depending on how long this lasts, I could see where HELOCs -- because they have jumped up. Usually, they're tied to prime. So, people are paying a lot more now than they were seven or eight months ago. So, I think doing that stress test of that portfolio, making sure that our borrowers are able to sustain that debt is going to be important.

MEMBER PILARSKI: Shane Pilarski, Northwest Indiana, Alliance Bank. As far as tightening lending standards like many in the room have said, we just never really loosened them and we've remained very conservative there. As far as what portfolios most concern me, I would have said a couple of years ago, we were primarily an ag lender. That has shifted. Whereas ag was our largest portfolio, it is no longer. As rates have risen, we used to be able to retain or attract ag clients because of our great client service. Well, with the rising rates, that kind of lessens in importance. And so, we're losing a lot of our strong borrowers to Farm Credit.

You know, Farm Credit is no longer that lender of last resort. They're seeking out the best ag farmers and business. And so that has really hurt and so we've had to transition as a bank. And now really CRE is our largest portfolio, which is a switch for us. We've had to make sure that we put in -- we stress test

things differently now. And so that's been a change. We are adapting to it. But it's not necessarily where we saw things moving.

MEMBER BATES: Once again, Thomas Bates. We're in the Clarksville/Nashville market. We have about 75 percent of our assets in the Clarksville/Montgomery County area and about 25 percent in the Davidson/Williamson County. Our market, we've always been a CRE bank. I think we had to start doing the quarterly profiles in about 2009 and have gotten pretty good at it over the years. We've added a lot of different metrics. We're tracking a lot of different metrics, but we do a fair amount of single family residential. We'll keep 125 to 135 construction loans going with a good majority being speculative. That's part of the nature of being in a military town. We also do a lot of multifamily, mostly smaller and we do have a fairly good size hospitality portfolio, but we stay away from conventions and things. We focus

on mid-tier flags.

We have not really seen any significant stress in that portfolio so far. We do have a different market in Nashville. You see a lot more institutional investors, basically people with other people's money. And we've tried to stay away from those. And really, we haven't had any problems in our HELOCs. We are starting to track the usage on a monthly basis. And that usage is still pretty well below 50 percent, so we're pretty happy with that.

So, most of our -- we have tightened that portfolio a little bit. We've tightened our metrics just a little bit on that just to be proactive. But we've tried not to tighten the standards as much as focus on pricing and relationships. So, if you're a good deposit customer, you'll get a better rate. If you're not a good deposit customer, you'll get a rate you probably don't like. And that's sort of how we've controlled it so far. But overall, we've

been surprised by how well things have held up in our market.

MEMBER OSTERBUHR: Arlen Osterbuhr, Midland Exchange Bank in Midland, Nebraska. Having been a banker in the 1980s, there's a lot of factors that are comparable today that there was in the 80s. I was a banker in the early 80s when I was a loan officer and also the manager of a Collection Department. And it was a very interesting time. And we were passionate about what we did and very concerned about our customers.

If the 80s taught us anything, we were cash flow lenders. We needed to become cash flow lenders. At the time we were collateral based lenders and that had to change and it has changed over the years. And I think more and more, we're using cash flows to tell us whether that loan is going to cash flow and make its payments on its own. In the 80s, we also looked at workforce. And it was hard to find a job if you were in the

workforce getting out of college as I was in the early 80s. And today, it's hard to find a workforce. Everybody's looking for somebody to come to work for them. It seems like all the banks around my area especially are looking for help, including us.

Residential lending in Midland, Nebraska today, we have three housing developments going on. And they're all three thriving and aggressive. And we've been very successful. We just completed a 54-housing development. And the three that are going on right now seem to be doing okay, even though we have higher interest rates. Although, as I look at the development and I think of our local lenders in my community of 3,200 people, having larger communities all around us, most all of us are using the secondary market. And not necessarily holding those loans in our own banks, which is unfortunate.

Auto loans, if you're making new car

loans, you are offering a rate that's really low. It's hard for us to make a new car loan in our area. Manufacturers have that market and seem to be offering prices that are much lower than prime rate.

Used loans -- used car loans, we try to be ten years old or less and our rates are higher. However, most of our local market is staying with commercial banks and making auto loans with us. And I would say there's probably not a lot of growth, but it's moderate if any at all.

Commercial loans, again we pride ourselves in being an agricultural bank. However, we've also diversified into the commercial area. And what we're finding is now that COVID is somewhat passed, people are traveling more. So, we're seeing more hotels pop up, more campgrounds being developed. Most people bought campers wanting to travel. Athletic venues, we're seeing a lot more club

sports and young people traveling for that reason. And so, we've seen a number of athletic venues being built. And pretty soon right next door is a new hotel, which has been good.

Small businesses and manufacturing has been very good. It's had growth, although moderate. Small business real estate buildings continues to be a very big part of our business in our area. And that business continues to be strong, although we look at many of those businesses as being family-owned businesses and then they're just expanding. Manufacturing has been good and we're fortunate for that reason too. Keeping people employed. Although we're all looking for help, it's keeping people who want jobs employed.

In the agricultural sector, our land values have gone up considerably the last few years. And again, cash flow lending is very important in the ag sector. And so, the input costs have been high, land prices have been high.

There's been a lot of stimulus money come in to that in the sector, along with government program payments. And a lot of that money in the last few years has been spent. And that's where the amount of deposits that we've had has gone down. It's been money that's been reinvested into their own business.

And right now, we're looking at commodity prices going down. And the commodity prices need to stay fairly high in order to cover those input costs that are out there; feed costs as you mentioned, cattle prices have all gone up. Commodity prices have to be there as well. And then I turn around and look at the consumer market and they've got to pay for that in the food counter. And that's where my concern is as well. So, my concerns are high cost of rents, no matter if it's residential property or commercial property, the high cost of vehicles. You can't find a lot of new cars on the lot. And if you are, you're paying for a higher price for them

and you're being probably financed through the manufacturer. Used cars are high, food costs are high, medical assistance and medical costs are high. So, the consumer is losing on most all these battles. And as Mike mentioned, nursing homes, hospitals, they need the help as well.

I've got an $8 million loan for our local nursing home. We have 60 beds in the nursing unit, 16 beds in the memory care unit, and 35 beds in the assisted living area. $8 million was the cost of rebuilding -- tearing down and rebuilding a brand new nursing facility. And that was in 2017. And I'm very thankful I've got a 90 percent USDA guarantee on that loan because they at times are struggling. Even with the people who pay their own way, because those are the ones that are paying the difference from the ones who can't. So, thank you.

MEMBER KITNER: Hi. Cindy Kitner, Jefferson Security Bank in Shepherdstown, West Virginia. I know I touched on the housing market

earlier, but just a couple other comments that I would add. We had the benefit earlier this year of adding an experienced chief credit officer and that's allowed us to focus on a lot of the concerns. You know, I would share in some of the staffing concerns, as well as the cost and the cost to all of our borrowers.

But more specifically within the portfolio, we are keeping a close eye on the construction market throughout the pandemic with the supply issues and others. We've seen a longer period with some of those construction loans than what we'd like to see. And now what we're seeing with the increased growth and the growth has continued is that we do have some of the builders that are into multiple projects at a time. And they're just not getting those completed in the time period that the homeowners would wish. So, we're keeping a close eye on that.

We are a high residential lender, so luckily, we don't have a lot of commercial

lending. But we are also keeping a close eye on all the commercial lendings and the projects that we have going on. The comments that were made earlier in regards to the deposits and making sure that we have that deposit relationship with the loan relationship is very important to us as well.

And lastly, as far as tightening lending standards, I would agree. I don't know that we ever loosened our standards. We've always had pretty tight standards and we want to continue to maintain those. We have seen some tightening standards with our competition, particularly with larger commercial construction projects that may or may not be of interest to us anyway. But we've seen just some recent discussions among the local bankers about some larger projects that you can tell that their interest in those is definitely less than it was before. Thank you.

MS. SCHMIDT: All right. We are

getting -- Would you like to -- Please. I think we have time for one more.

MEMBER CAMPBELL: Yeah. Troy Campbell from Altoona First Savings Bank in Altoona, Pennsylvania. As far as tightening standards, we haven't really tightened standards, but we have looked much more closely at projections. We do a lot with small businesses and projections. Interest rates are going up. Developers know that. So, we're watching like cap rates that they're using.

We're seeing they're starting to increase cap rates. And one of the things in our community that's happened is it's been a beautiful thing to see a lot of, you know, young people have left our community, but they're returning back home. And you know, in our community, it's kind of crazy, but our kids come back and they don't want a house. They want to have, you know, a unit to live in. And we don't really have that in our market.

So, it's been something that developers have been really aggressive on. But we're also seeing, you know, market rate. That wasn't even a thing in our community and now it's a huge thing. But the developers, I think, are getting a little excited about that and starting to project higher cap rates than we believe are reasonable and that are sustainable. So that's been a big thing for us is watching the assumptions that are going into projections.

MS. SCHMIDT: All right. Well, in the interest of time, I know we can talk about credit risk for hours. But thank you all. You know, you did a great job. You covered residential, CRE, consumer, ag. I think we've got it -- got it nailed down. So again, thank you. And I'll let Nikita move to the next subject.

MS. PEARSON: Thank you very much, team. And thank you all for sharing your perspectives. That was a very engaging discussion. So, after talking about a very

important topic about credit risks, it's also important for us to move to another very important topic. And we're going to start this conversation off a little bit differently because I'm leading the discussion and I like to start things off differently.

So, I would like to ask you to take probably like a quick minute and close your eyes for a second. And as you close your eyes, I will ask you to visualize a meeting at your institution that you were in and an important decision was being made. And visualize who was in the room.

Now I ask that you visualize the individuals who were impacted by the decision that was being made in that room. Now I ask you to think about a time an important decision was made that impacted your life and you did not have an opportunity to influence that decision. And think about how you felt.

Now I ask you to open your eyes

please. I have two rhetorical questions for you. How do you make the invisible visible? And how do you create opportunities for everyone? My job today is to help convince you that one way we can help you is for you to complete -- take advantage of the opportunity, complete the diversity self-assessment.

Now if I can't convince you with the facts I'm getting ready to lay out, I hope that you're moved by the feeling that you have while your eyes were closed. So, let's get to the facts. There was a study done by the Federal Reserve in 2019. That study said that revenue ratios increase once the share of women on the Board increased to just 17 percent -- just 17 percent, the revenues increased.

A 2015 study by McKenzie said that the top quartile for racial companies with racial and equity diversity -- I'm sorry -- ethnic diversity. They're 35 percent more likely to have financial returns above the national average

for their industry. And you notice the timeframe for these studies are a little bit older. This isn't new information.

If you haven't heard about the Office of the FDIC, named the Office of Minority and Women Inclusion is also not a new office. And it's also an office at other federal banking agencies. It was created in 2010 based on Section 342 of the Dodd Frank Act. Within that Act, the federal agencies came together and created the joint standards that were established and issued out in 2015. These were joint standards related to diversity. And we put out these joint standards and we came up with the self-assessment. And it is simply that, the self-assessment. And we ask that you voluntarily complete it.

The FDIC has over 3,000 banks that we are the primary federal regulator for. Less than 200 complete the self-assessment and submit it to us. We are aware that there are some who complete

it and don't send it to us. And I heard anecdotally why that is. And I'm here to convince you that not only would we like for you to complete it, we would like for you to submit it to us and we think it will benefit you because Troy, one day, I'm going to get you to say I am from the Federal Government and I am here to help. Those are the words I want you to say out of your mouth one day. All right? It's a deal. That's the deal we're going to work on.

So here are some common, what I call some myths that I would like to address that I think will help you make that decision. We actually extended the open period for the diversity self-assessment. It was originally scheduled to close on September 30th. Because of this meeting, we extended it to October 20th because if you have not completed it, I'm asking you if you will consider to complete it by October 20th. And if you will call three of your peers at other institutions and ask them to consider to

complete it. And that's also for the individuals who are watching on a livestream.

The first thing I would like for you to consider that if you complete the diversity self-assessment, it is not a part of your safety and soundness or consumer protection examination ratings. It is not considered as a part of your Community Reinvestment Act performance evaluation. When you complete the self-assessment and submit it to our office, it stays with our office. It is not a part of your exam findings.

The other piece of information is once you submit it, it does not go into a government black hole. We actually do review your information. And we review it with the purpose of identifying some promising practices that we hope to share with you. The reason that's helpful -- potentially helpful for a community bank, because a lot of community banks don't necessarily have the opportunity to have

dedicated staff to focus on diversity efforts.

So, if we can get information from a number of banks and identify those promising practices, we can share that information with you if you don't have the staff. And we can put it in a report. If you went out to the FDIC’s website and go to our financial institution diversity web page, you will see where we've identified promising practices that you can take advantage of and see for free. That's the advantage that you get when you share that information with us.

You should know that we do not share your individual bank data that you send to us. We do share the information in aggregate, but not individual bank data. You should know if you have any questions, you don't have to do this alone. We have individuals who will answer any questions that you have. There's an email address called bankdiversity@fdic.gov -- bankdiversity@fdic.gov. If you email us and you

want to have your answer -- question answered by email, we'll do that. If you email us and you want a person to call you back, we will do that as well. You don't have to do this alone.

If you're worried about the amount of time that it takes, when this was just the paper form, we estimated it was eight hours to complete the form. Since that time, we've automated the form and we've added what we call -- I used to call it the copy and paste feature, but the IT people wanted me to call it the cloning feature, which is apparently the appropriate term for this. And so, it's more efficient and effective. That means that once your team inputs the data, if that information remains, it automatically inputs it for the next year and you just have to update the things that changed. And so, it becomes more efficient and effective year after year.

If your bank is the size of 100 or more and you submit a report, your EEO1 to the

EEOC already, you don't have to worry about it. The information you report to them is the same information that you will report to us as far as it relates to workforce data. So, it's not new information that you have to create.

If you are an institution and you have a bank holding company and you by some chance submit your information to the Fed by mistake, don't worry. We talk to our friends at other regulators. So, we talk to each other, so if you send it to one, we talk to each other. We can exchange it and get it from the other.

If you by some way decide that you only want to complete the workforce data and you don't want to complete the supply diversity data, you don't have to complete every box. We would love for you to complete every box, but you don't have to complete every single box. You actually don't have to submit the information to us. We just ask that you complete it at the minimum, but you don't have to. It will help you more if you

submit it to us because we can get you more information. But at least complete the self-assessment.

You don't even have to complete the form in a format that we provided to you. If your financial institution has a different way that you complete or assess yourself in the space of diversity, equity, inclusion, and accessibility, you can submit that information to us in the form that you use it and you can just email it to us that way. We try to make this as simple and as easy as we can. And we will take it from there. If you think that you are the only ones who have to do this, don't worry. In the part of the country that I'm from -- I'm from Georgia. If you've noticed, I'm not from D.C. -- we have this saying called sweep around your own front door. Federal agencies are the same way. We have to report our efforts to improve diversity, equity, inclusion, and accessibility. In fact, our data is publically

available just like every other federal agency. And we are also working in this space. So, it is not something that we're asking you to do, that we're not working on ourselves.

So, with that being said, those are some of the reasons that I've heard people say that they have not -- bankers say that they have not completed diversity self-assessment. But I wanted to clear those things up and open up the floor to any questions that you may have. I'm happy to answer them. This is way too easy.

MEMBER JAMES: I've got a basic question, Nikita. Thank you very much for the information. How do we find the survey? And who's the right person inside the institution typically to complete it? Is it more of an HR-related survey or is it something that at the C-suite level, we would need to review?

MS. PEARSON: So, the first question is, so we issued out a financial institution letter with the diversity self-assessment. And

then I believe we placed a copy of it in your materials. In addition to that, we can make sure that we send it out to all of you again. We'll make sure we do that. Generally, the workforce person, your HR person will have the work force data. If you have someone that's a supplier diversity -- has supplier diversity responsibilities, they could complete it. But it generally depends on how you divvy out your responsibilities. But I would start generally with your HR staff or if you have a chief diversity officer designated.

MEMBER CAMPBELL: Is it available on the portal as well?

MS. PEARSON: It is available on your portal, yes. Thank you for that, Troy.

MEMBER MJARTAN: I wanted to ask a couple questions. First of all, I want to thank you and the Chairman for creating space for this at this meeting. I think it's really important to do this, not just because I believe it's the

right thing to do, but it's also very productive as you pointed out.

We just completed company-wide training and we had 98 percent of the employees participate in it. It was a very big success in my opinion. But the trainer that we hired pointed out a lot of the same statistics that you shared, but went much deeper. And I know you were trying to be brief. I will say my reaction was I was stunned to see that particularly for the banks where they actually correlated some ROA results with diverse board and executive management. They were able to find significant correlation over a long period of time.

So, my question to you would be do you have on those 200 banks, is there anything you could share in aggregate to see how them just simply completing the survey correlates with their performance. And how does their performance stack compared to the other, you know, 3,000 or 2,800 banks that didn't complete

it?

MS. PEARSON: That's a great question. I don't have that information available with me, but that's something I can look into.

MEMBER MAUST: Just a real quick question. The estimated time of eight hours might seem a bit daunting for 3,000 banks. They're looking at it. Is there an option to fill out portions that maybe, you know, ease a bank into it and then obviously on follow on basis, they'd probably, you know, continue to fill out more and more, and eventually, you know, the entire survey?

MS. PEARSON: Yes. A lot of banks if they just want to get started on it, they first start with the workforce data and just start there and maybe leave the supplier diversity portion alone and just look at what does my workforce look like? What does my Board look like? What does my management team look like? And when I say look like, meaning provided

demographic data.

MEMBER MAUST: And that's helpful for the FDIC? Okay.

MS. PEARSON: It is very helpful.

MEMBER MAUST: Great, thanks.

MS. PEARSON: Thank you.

MEMBER REIGELSBERGER: So, the question --

MEMBER RICHARDS: Oh, I'm sorry. Go ahead.

MEMBER REIGELSBERGER: I was just going to ask real quick, is this -- when we submit this, is that tied back to our bank? Is it anonymous or just figuring out how that worked?

MS. PEARSON: Oh, yes. Absolutely. So, when you submit it to us -- When I say us, meaning it comes to the FDIC, but it comes specifically to the Office of Minority and Women Inclusion, where I work. It does not go anywhere else outside of my office with your bank's name on it. We share it in aggregate, meaning we just

take the data and add it all up together and that's where we publish it. But no one else outside the individuals in my office will see your individual bank data. And then, within the financial institution letter, there's a statement that we have and there's some legal language there related to the FOIA. But other than that, we don't share your information.

MEMBER REIGELSBERGER: Okay. Thank you very much.

MEMBER RICHARDS: Just a follow-up on Trey’s question. It sounds like there's different sections like supplier and different sections. But within a particular section, if you don't answer all of the questions, will you get some sort of evil warning message at the end, you did not complete every question within this section or can we pick and choose, you know, some questions might not be readily available what the answers are. Some are going to be easier than others. So, within each -- within each section,

can we leave questions blank?

MS. PEARSON: Remember Troy, we're from the government, we’re here to help. There is no such thing as evil.

(Simultaneous speaking.)

MS. PEARSON: Trust me. So, you only have to complete the ones that you want to complete.

MEMBER RICHARDS: Okay.

MS. PEARSON: You will not get a -- it's not a case where you have to complete a section. If you only wanted to open the self-assessment and literally only answer one question --

MEMBER RICHARDS: Okay.

MS. PEARSON: -- you can do that.

MEMBER RICHARDS: So, you're not like the Federal Reserve and their systems.

MS. PEARSON: I'm not going to take that bait. Other questions, concerns?

MEMBER REIGELSBERGER: Just this is a

quick review in my mind. I've been in senior management for 30 years. It's nice to see if nothing else in this Board here, even though it's primarily male and female and some minority, as my years in banking, it's always been a male-dominated field. Any time I've ever attended anything, I was the minority. And it is nice to see that a little better represented here. So, thank you.

MS. PEARSON: Thank you. And I think the Chairman has certainly made a concerted effort to ensure that we brand under his leadership to make sure that we have a commitment to diversity, equity, and inclusion here.

MEMBER MAUST: There's a word you've been using that I find interesting. About two minutes ago you said accessibility. Could you talk just briefly about that? And then I was curious, is there may be a carrot, such as would it be like a positive point on your management rating? The accessibility is what I'm really

interested in just given the state's special needs and I don't know what it entails.

MS. PEARSON: So, remember, it's not connected to your examination rating. So, there's no carrot there. Accessibility really relates to how do we ensure that people have the ability to access the different things? And I'll give you an example of something that happened within my work unit. The FDIC, there are federal goals as it relates to hiring individuals with disabilities. And that's appropriate for us to talk about because it's actually National Disability Employment Awareness month. And the FDIC has consistently exceeded those goals. And we have a very strong record with that.

During the pandemic, we were mandatory telework and we held all of our meetings virtually. I have a wonderful colleague on my team who's deaf. And we were working on the virtual meeting and this individual did not have a sign language interpreter for the meeting we

were having. And I asked how can he participate in the meeting? And the response I received was well, he can turn on the Teams captioning -- closed captioning.

So, I turned on the closed captioning to join the meeting the same way he would join the meeting. When I turned on the closed captioning, all I saw was a bunch of words. Living that same experience with him, what I realized was, that was what he saw. So, he was trying to look at the people on the screen and read the words. And I said well, why can't -- why can't there be names with each individual as they're speaking so he can determine who's doing the talking.

And so, I called the chief information officer here at the Agency, Sylvia. And she said, oh, all we have to do is just turn on the switch, and she did. Accessibility isn't just the representation of individuals that have a disability. But how can we make sure that they

can have the same experience with the same access? And that's what I mean by accessibility. And sometimes that means doing life together because if you had asked us, we would have said we have a great record because we have great representation. And for the most part, everyone has a great experience. But until we did life together, that's when we recognized we had an opportunity to have more accessibility. Did I answer your question, Trey?

MEMBER MAUST: You did, thank you. We have autism directly in our family, so I fully appreciate that. That's why I asked the question. So, it's expanded into that as well. Okay, thank you.

MS. PEARSON: Thank you. Other questions? All right. So, we will keep moving into the next part of our agenda. I would love to invite my colleague, Betty, up to the table for us to have an update on our Minority Depository Institutions Subcommittee meeting.

Betty is the Director of the Office of Minority and Community Development Banking. And then Warren who is already at the table with us, Warren Huang, serves on both this Committee and the MDI Subcommittee. And they will provide us an update from yesterday's meeting.

MS. RUDOLPH: Thanks, Nikita. Just a brief reminder, the MDI Subcommittee was established under the authority of the Advisory Committee on Community Banking. That's all of you. And the Federal Advisory Committee Act requires that any subcommittees provide advice or recommendations to the FDIC through this committee. So that's why we're appearing before you today.

So, the MDI Subcommittee reports directly to all of you, not to the FDIC. And we have three goals for the MDI Subcommittee. The first is to serve as a source of feedback for the FDIC and our strategies to fulfil the goals that -- the statutory goals that we have to preserve

and promote minority depository institutions.

Secondly, to provide a platform to promote collaboration, partnerships, and best practices. And third, to identify ways that we can highlight the work of MDIs in their communities.

So the Subcommittee is composed of nine executives -- MDI executives representing a diversity of types of MDIs. So African-American, Hispanic, Asian, and Native American. And we have a range of business models, size, and geographic mix. So, the nine members of our MDI Subcommittee represent about 10 percent of the 98 MDIs that we supervise. And in addition to the MDI Subcommittee, we have four MDIs represented on this committee: Robert James, Dominik Mjartan, Andrew West with Eagle Bank, and Warren Huang.

So, we met yesterday afternoon, and I'm going to turn it over to Warren to provide an update from the meeting.

MEMBER HUANG: Thank you, Betty. At this time, the MDI Subcommittee does not have any

recommendations for the FDIC. But the subcommittee does want to share a brief recap of yesterday's meeting. So, at yesterday's meeting, we received a presentation on current economic and banking conditions and selected MDI financial performance indicators. So similar to our discussion here today at CBAC, we responded to the same questions about funding, interest rate risk, and credit risk. We had the same discussions -- similar discussions.

During the MDI's spotlight, we heard about a unique collaboration between 16 MDIs and CDFIs that came together to do a $78 million syndication loan to the National Football League. The discussion included perspectives from some of the institutions that supported the collaboration, including the National Black Bank Foundation, Bank of America, as well as two MDIs; First Independence Bank in Detroit and Industrial Bank here in Washington, D.C. They shared their thoughts on what worked well, lessons they

learned, recommendations for future collaborations, and for companies that might consider working with community banks, MDIs, and CDFIs borrowing needs.

So, the subcommittee found the presentations useful. I believe that FDIC will place the video on its website so MDIs, CDFIs, community banks, and corporations can all learn about the collaboration. And we also had a briefing from FDIC on the June 2023 update on third-party guidance, as well as cybersecurity updates and information about the upcoming Interagency MDI/CDFI Bank Conference that will be held in Dallas at the Federal Reserve on November 15 and 16. And that concludes the report from the subcommittee. So, any questions, Betty and I would welcome them.

MS. PEARSON: Well, it is lunchtime. Thank you both, Betty and Warren, for that update. We will break for lunch and we will -- oh, we'll take a -- we are doing -- we're not

doing the photos. Right? No, okay. Awesome. We will have lunch upstairs and we will return here at 1:00 p.m. Thank you.

(Whereupon, the above-entitled matter went off the record at 11:33 a.m. and resumed at 1:07 p.m.)

MS. PEARSON: Welcome back from lunch. And I've heard a few people comment, you are correct, we turned the temperature down. So, there will be no sleeping after carrot cake. It will stay nice and cool in here.

So, you may have noticed we have a few new colleagues here at the table with me. We will have now our supervision and policy updates. At the table you will see my colleague Mark Pearce, who is the Director of the Division of Depositor and Consumer Protection. Mark will be hanging out the entire panel.

And first up we have Lisa Arquette, who's a Deputy Director in the Division of Risk Management Supervision. Lisa will chat about

banking cannabis-related businesses.

And we also have Suzanne Clair, who's an Associate Director in the Division of Risk Management Supervision. And Suzanne will speak about funding and liquidity risk management. And we'll keep going into different panels.

But I'll turn it over first to Suzanne, correct?

MS. CLAIR: Good afternoon, everybody.

MS. PEARSON: Good afternoon.

MS. CLAIR: Hi. Yes, so I think, yeah, this is the first chart.

So, we've headlined this Asset Liability Management. We wanted to talk about interest rate risk management and liquidity risk management under that umbrella of asset liability risk management.

So, we wanted to share a few slides with you on some charts that show trends in liquidity and interest rate risk at community banks. This data is from call reports for

community institutions.

So, this first chart shows the weighted average yield on earning assets, net interest margin, and cost of funds for community banks. And as you all are aware, the pace of the current rising rate cycle is nearly twice as fast as previous rate cycles, rate hiking cycles.

Since March of 2022, the Federal Open Market Committee, or FOMC, has responded to the high inflationary environment by increasing the Fed Funds target range by over 500 basis points. These charts reflect June 30 numbers and data, but we saw as recently at 9/30 that the ten-year treasury closed at 4.579, and at 6/30 it was 3.819.

So, looking at the chart, the Fed Funds rate is indicated by the dashed green line. This chart's showing that recent quarters indicate that NIMs are compressing, shown in yellow, as the increases in weighted average cost of funds, which is shown in the red line, outpaced

increases in earning asset yield, which is shown in the dark blue line.

So, over the past six months, weighted average cost of funds has almost doubled, increasing 77 basis points. And the weighted average yield on earning assets increased 45 basis points during that time.

So, moving to the next slide, this slide highlights some balance sheet liquidity trends over the past several years for community banks. On deposit growth and loan demand, during the pandemic resulted in significant growth in securities portfolios.

Some banks made investment decisions underestimating a potential rate hiking pace, and the increases in the Fed Funds target range led to corresponding increases across the U.S. treasury yield curve's term structure, as we discussed. As market interest rates increase, as you know, longer duration assets, including debt security's decrease in value.

So, over the past year, you can see in the chart some of the deposit growth that we saw during the pandemic has run off and been replaced with wholesale funding. So, this chart shows deposits as a percentage of total assets in the orange line, and wholesale funding in the dashed black line.

Additionally, the trend of a build-up in the securities portfolio, shown by the blue line, is beginning to reverse as loan demand, which is shown in the dotted purple line, picks up.

So, moving to the next slide, this slide illustrates deposit composition and asset growth, with weighted average cost of funds overlaid as the red dotted line. So, as you can see, deposits grew significantly during the pandemic, but over the past two quarters, community banks saw a shift from MMDA and other savings accounts into time deposits.

The shift in deposit type, coupled

with increasing market rates, contribute to the significant increase in weighted average cost of funds.

So, moving to the next chart, as we mentioned in a prior slide, over the past year there's been significant increase in wholesale funding, which is primarily centered in increases in borrowing, brokered, and reciprocal deposits.

And as of the second quarter of 2023, of June, the volume of broker deposits at community banks, which on this chart's shown in the blue line, in the light blue -- I'm sorry, in light blue, are at the highest level since 2018 at least. They increased from 86.2 billion at year-end to 112.3 billion.

So reciprocal deposits, shown in yellow, are at a new peak, increasing from nearly 70 billion at year-end 2022 to slightly over 100 billion as of the second quarter.

And lastly, borrowings, including Federal Home Loan Bank advances, are shown in

green, and other borrowings shown in purple. These increased from 108 billion at year-end to 143 billion in the second quarter.

So, our last chart, which is the next slide. This chart shows the impact of higher rates on investment portfolios, again, through the second quarter. The chart on this slide illustrates again the rapid increase in unrealized holding losses on investment securities. And this includes not only the available for sale, but the held-to-maturity security portfolios.

Again, this chart shows the rapid increase in these unrealized holding losses, consistent with the jump in the ten-year constant maturity treasury rate, as shown here in the dashed blue line.

Again, from a capital perspective, both AFS and held-to-maturity net unrealized holding losses net of tax are not factored into regulatory capital for most community banks. And

this is because most institutions have opted out of AOCI, or accumulated other comprehensive income, which are net gains or loss to treatment for AFS securities and it's in accordance with the generally applicable capital rules.

And additionally, held-to-maturity securities are not measured at fair value for financial reporting purposes. However, equity capital that's defined by GAAP reflects AFS net unrealized holding losses. So therefore there are some institutions that now have significantly lower gap equity compared to regulatory capital.

And given the increases in long-term rates, especially as I mentioned these recent increases in September that we see, it's anticipated that there will be even more institutions that will have low or negative gap equity capital.

So, it's important to point out that most bonds that experience these market value declines will likely make timely interest and

principal payments but -- up to maturity, but while there may not be credit risk, the interest rate and market risk presented by these bonds with these significant unrealized holding losses has various implications for liquidity and capital.

So, moving on to slide 7, where we completed our charts, we wanted -- I wanted to just update everybody on, I think at the last Community Bank Advisory Committee meeting, that my supervisor, Ryan Billingsley, discussed a lot about liquidity, liquidity funds management, contingency funding planning.

And since then, the agencies issued an addendum to our 2010 Interagency Policy Statement on Funding and Liquidity Risk Management. And that addendum focuses on the importance of contingency funding plans.

So again, that was something that was issued by the FDIC, OCC, and the Federal Reserve in late July. Again, this update serves as a

reminder that banks should maintain actionable contingency funding plans that take into account a range of possible stress scenarios.

There's more detail in the full statement, but at high level, depository institutions should do the following: maintain actionable and operationally ready contingency funding plans that are updated to and address evolving liquidity risks and take into a range of appropriate -- a range of appropriate stress scenarios.

And also assess the stability of their funding and maintain a broad range of funding sources. And then strongly consider incorporating the discount window as part of contingency funding arrangements.

Institutions should also be aware of the operational requirements to obtain funding from contingent sources and also the importance of testing contingent funding sources on a regular basis is emphasized.

And then again, the statement also emphasizes importance of understanding and having collateral available for contingency funding needs and understanding the potential operational challenges, as well as reviewing and revising your contingency funding plans.

And that pretty much is most of my remarks. Does anybody have any comments or questions?

I'm just kind of curious too to ask if any of the charts resonate with the committee. Have you seen shifts in your time deposits or funding profiles? I know, it's very challenging, right. So. Sure.

MEMBER RICHARDS: You talk about the discount window. We've never applied for that or used that in the past. We've been an FHLB advance borrower. But we've been hearing that we will be criticized if we don't have a discount window application in process or you know, in place rather.

So, we're going through that process. We're still with the Fed, it's challenging, but we're getting there. But the Bank Term Funding Program specifically. You know, we're not going to worry about that because it's coming to an end first part of next year anyway. I've heard it might be extended.

But if we were to have an exam, would there be any -- I understand there might be some criticism if we've not signed up for the discount window. Would there be any criticism if we didn't sign up for the Bank Term Funding Program?

MS. CLAIR: No, I would say no. The Bank Term Funding Program would be if your institution had a large amount of unrealized losses and was trying to manage through that. That's really what that program was intended. Because then you could borrow against those at par.

But as far as we know it is going to end late March, I think 24th was the date.

MEMBER RICHARDS: Right.

MS. CLAIR: But yes. And we -- the statement encourages and the FDIC is one of the agencies encouraging institutions to sign up for the discount window. I think it's important --

MEMBER RICHARDS: And we only have four securities in our securities portfolio. So even if we want to borrow from the discount window, I think we'll have to put loans up. And it's maybe loans that FHLB does not count. So, we haven't gone through that process yet, so we're going to go through that.

CHAIRMAN GRUENBERG: All right, if I could just ask, I think one of the lessons learned from the failures earlier this year was the need for institutions to be prepared if necessary to access discount window borrowing, particularly in the event of stress.

And I think part of the objective here, if I can say, is to -- there still seems to be concerns about a potential stigma in utilizing

the discount window. Which frankly we want to try to push against by making it a, in effect a, as it were, normal source of liquidity that an institution can draw upon with reliability if it has the necessary collateral.

So, I would be interested in hearing from you all your thoughts on this stigma issue and how big an issue is it for you, and any thoughts you have in regard to it.

MEMBER DRENTLAW: Well, as a fourth-generation banker, I think there's a bigger stigma with my father than there is with me. Me, I'm kind of trusting I guess that if we need those funds, that we would be able to draw on it and not have the stigma with it.

We would still use our FHLB line. Quite frankly, it's way easier to draw on. We did the Bank Term Funding Program, and it was painful. It's a painful process to get the money, to pledge things. So, there's part of me that hasn't done the discount window because of just

the logistics of it.

But that being said, if it was needed because of liquidity, I won't hesitate to draw on it.

MEMBER HORTON: I'll just add that we love using it. And we were able to lock in, you know, a lower rate. There's no prepayment penalty. If rates were to go down, I mean, you get better value for your collateral.

We signed up very early, and I think we have, you know, almost probably about 80 million on it. And we're not worried about a stigma. I mean, I remember hearing those things about PPP borrowers were going to have a stigma associated with them.

I just think that it was a very appropriate and wise tool that you put in place for us, and we really appreciate having it. Thank you.

CHAIRMAN GRUENBERG: That's very helpful, thank you.

MEMBER RICHARDS: You know, when we were here last, we were talking about this FDIC insurance report that you all came out with that, you know, we were going to look at changing things up. Well, that's kind of died down. And I think the smart thing to do on that is nothing.

And that kind of correlates to this stigma idea. I think when everything was hot and heavy with SVB and Signature, there would have been a stigma of being on a list. But I think kind of like with FDIC insurance, nobody really cares now, so if you borrowed from it.

I would be more worried if the regulators would frown on us for using it more so than the public stigma. And I would hope that there would not be any regulatory stigma attached to that.

CHAIRMAN GRUENBERG: That's why I'm asking the question in part, because.

MEMBER MAUST: And I didn't see it on our agenda today, but I did see, Mr. Chairman,

your remarks yesterday at the Research and Policy Conference regarding the insurance, attempts toward insurance reform.

And I know the desire publically for that has kind of waned, but your comment about being prepared, I think that's another example of we may not need it today or the public doesn't see the need for it today, but I think that's something that we -- do one or both, we can keep pushing it about dialog.

And back to the question regarding the TFP. We'd accessed TFP too. It was a interesting process to go through to get it set up. But we now have access to the discount window and TFP.

I think the concern we initially had was we remembered what TARP was like. And it wasn't so much that people were interested in identifying who it is that accessed TARP, it was the media. And I think that's something that agencies can get ahead of and just remind everybody that this was put together in a prudent

manner for a particular reason.

So, I appreciate asking the question.

MEMBER SHOEMAKER: And we had access to the discount window for many years, a long time. And it was seamless signing up for the Bank Term Funding Program. We didn't have any difficulties. But we have also not accessed it.

MEMBER JAMES: Yeah, similarly we had discount window access. And so bank term funding was simple. We have not used it, we tested it, but we have not needed it. Because we're quite liquid, so.

CHAIRMAN GRUENBERG: Thank you.

MEMBER MAUST: Can I ask a question regarding reciprocal? And that came up earlier today.

We did see -- we had used it as a tool for larger borrowers that wanted to stay with a local institution or where there's a strong relationship. A lot of it was perception-related in terms of, you know, a small institution versus

a money center or a G-SIB.

But it did level the playing field somewhat when there were no eligible depositors who also had corporate governance that understood that this covered it in the same fashion that in their minds a large institution's strength would.

I'm curious if reciprocal deposits are looked at differently, other than having a good understanding of why the relationship is there. I see it listed as sort of in the same buckets as volatile funding sources.

And so, I wanted -- and I recognize that could certainly be the case if the terms are disparate between maybe alternate sources. But I'm curious if it's considered in the same bucket as, say, like FHLB advances or brokered CDs things like that.

MS. CLAIR: I would say it's probably the size of the, you know, the deposits that's creating the look at it, the view of it as wholesale, and that those investors are likely

more sophisticated and you know, financial -- like and institutional investors or rate-dependent investors, so depositors.

So, it still falls in the bucket. We view it as wholesale, but you know, it has different characteristics. So, it's hard to give fast and steady, you know, definitions of how they'd be viewed compared to other funding sources.

MS. PEARSON: We're ready to move on, Suzanne.

MS. CLAIR: Sure, thank you, thank you.

MS. PEARSON: Lisa.

MS. ARQUETTE: Thank you, Nikita.

Hello, my name is Lisa Arquette. I serve as the Deputy Director for Operational Risk in the Division of Risk Management Supervision. This afternoon I'll be discussing or highlighting some cannabis-related business matters and other information for you. I understand that's a key

concern for many state bankers. Slide 2, please.

As you know, nothing has changed in terms of marijuana being considered a controlled substance, Schedule I controlled substance. What that means is that it has a high potential for abuse with no acceptable medical use. Under federal law, the cultivation, distribution, and possession of marijuana is prohibited.

Notwithstanding the federal ban, the majority of states and the District of Columbia have legalized some form of marijuana use. I may refer to it as cannabis, which is the plant from which it's derived.

The National Conference of State Legislators tracks the number of states, territories, and the District of Columbia that have legalized the use of cannabis for medical and other purposes. As of the second quarter of this year, 38 states, three territories, and the District of Columbia allow medical use of cannabis.

Twenty-three states, two territories, and the District of Columbia have enacted measures to regulate cannabis for adult non-medical use. I believe that's referred to as recreational use. Next slide, please.

Before I get to any additional comments about regulatory requirements for marijuana-related businesses, I think it's important to clarify our position regarding any customer account. The FDIC recognizes the importance of ensuring public access to financial services for consumers and businesses.

The decision to open, close, and decline particular account relationships is made by the institution and should be based on business objectives of the bank, the evaluation of associated risks posed by individual customers on a case-by-case basis, and implementation of controls to manage the relationship commensurate with the risks.

As a general matter, the FDIC does not

direct banks to open, close, or maintain individual accounts or encourage banks to maintain -- or encourage banks to terminate entire categories of customer accounts without regard to the risks presented by an individual customer or the bank's ability to manage those risks.

I would refer you to financial institution letter 05 issued in 2015. It's titled The Statement on Providing Banking Services just to reiterate our position.

And with that said, I'll move into the regulatory requirements associated with having marijuana-related businesses. What I highlighted on the first slide, and I am on slide 4 now, what I highlighted on the first slide was the difference between federal and state laws.

The Financial Crimes Enforcement Network, which is a bureau within Treasury, they serve as the administrator of the Bank Secrecy Act. So, the Financial Crimes Enforcement

Network is the administrator of the BSA.

On February 14 of 2014, FinCEN issued Bank Secrecy Act Expectations Regarding Marijuana-Related Businesses. The guidance was issued to financial institutions to clarify Bank Secrecy Act expectations for banks seeking to provide services to marijuana-related businesses because, again, it's a controlled substance.

At the same time on the same day, the Deputy Attorney General James Cole issued guidance to U.S. Attorneys specific to marijuana enforcement. It's referred to as the Cole memo.

One of the key objectives of that memo was to highlight and focus limited investigative and prosecutorial resources to address the most significant marijuana-related cases in an effective and consistent way. So, these two pieces of guidance came out on the same day.

The Cole memo has since been rescinded, but the FinCEN guidance remains in effect. And the FinCEN guidance refers to the

priorities that were identified by law enforcement. I'll give you two. These are very intuitive for everybody in the room, I'm sure.

But it would be preventing the distribution of marijuana to minors, preventing revenue from the sale of marijuana to go to criminal enterprises, gangs, and cartels, and then there are six others. But these are key priorities that were established by DOJ a number of years ago and that have been reiterated in FinCEN's guidance.

Separately from those priorities, FinCEN has identified red flags that could help any financial institution identify some unusual activity related to this type of relationship, this cash-intensive business relationship.

They also identify due diligence procedures that financial institutions could follow when evaluating the customer relationship and conducting ongoing monitoring of that customer. That's something that you do for all

customer types.

That would be no different, right -- you establish a customer risk profile for money laundering, terrorist financing, and other illicit financial activity risk, and you monitor that account regularly, or your staff does. And if there's something unusual, you would file a SAR.

But in this instance, because it's a controlled substance, FinCEN issued guidance about filing suspicious activity reports, as well as the currency transaction reports.

They had three categories identified. One was a priority SAR, and that would be filed, designated and filed when the institution, the financial institution, thought that it triggered one of those priorities.

So, if they had reason to believe that the proceeds were being used to fund gangs or cartel members or that these proceeds were used or derived from selling to minors, an institution

would place that on the SAR.

If it was just a normal customer business except for the product that we're talking about, the bank would designate suspicious activity report as being limited, a SAR-limited.

And in instances where the bank chose to terminate the relationship, they would also make a designation. The reason for this it to help not only law enforcement keep track of the types of suspicious activity that's being reported by financial institutions, but also for analytical purposes.

What does this mean, how many banks, credit unions, securities brokers and dealers, money service businesses might be engaged with marijuana-related businesses that are a priority for law enforcement? Ultimately that's what the purpose of the SARs is.

So that remains outstanding. Now, the examination experience may be, you know, a

question for you, but our examiners evaluate these accounts like they evaluate all accounts.

Banks will establish a risk assessment, a baseline risk assessment for all of your products, services, products and geographies in which you operate. That would be called a risk assessment for money laundering, terrorist financing, and other illicit financial activity.

What feeds into that are customer risk profiles. Banks will develop high-risk lists so that they can monitor those accounts differently, spend a little more time, collect a little more information, and determine what steps they need to take.

Sometimes it might be filing a Suspicious Activity Report, sometimes it's asking the question of the customer and getting the answer and understanding why cash flows change. But that's your customer risk profile, and that's the monitoring for suspicious activity. The same expectation for these types of accounts.

So, an examiner, if you've identified marijuana-related businesses as high-risk businesses, they may sample those accounts when they go in just to evaluate what you do. If you've opened a new account, they may look at your new account opening procedures.

But generally they're going to treat them no different than other accounts, except that they're going to check that you're following the FinCEN guidance as far as filing Suspicious Activity Reports and filing large Currency Transaction Reports if you get a high volume of cash, more than $10,000 on any given day, deposited or withdrawn.

So that's the guidance. Nothing's changed since 2014. This has been a controlled substance for a long time. But I did hear that in August of this year there is a proposal to move marijuana from a Schedule I controlled substance to a Schedule III controlled substance.

Is it still a controlled substance?

Yes. But is it migrating a little bit? Possibly. We'll have to wait and watch. We don't know, we're not in control of that at all.

I would ask to move to the next slide and highlight something else that's very, very related. So, marijuana and hemp come from the cannabis plant, same plant. The difference being that hemp has no more than 0.3 percent of tetrahydrocannabinol. I'll refer to that as THC going forward.

THC is commonly associated with the altered state of mind. So, it's really specific in the growth of the cannabis plant. That is no longer hemp, less than 0.3 percent THC, that is not a controlled substance. It's just like any other crop, but I understand that it's highly regulated by most states.

That is not a controlled substance. It comes from the same plant, but you do have to know how much THC is in the hemp to make sure that you're complying with the FinCEN guidance.

So, I would ask that you move along to the next slide. Thank you, Lisa.

The FDIC along with the other banking agencies issued some clarifying -- issued a clarifying statement regarding hemp that aligned with the Farm Bill of 2018, where hemp was removed as a controlled substance pursuant to the Controlled Substance Act. So that financial institutions were aware that we would no longer for Suspicious Activity Reports unless of course a customer engaged in the business of producing or distribution or selling hemp met some other criteria for unusual activity. That's up to the institution to identify that.

So, they would be treated as all customers, and if there was indication of some type of unusual or criminal activity, then you would file a Suspicious Activity Report.

FinCEN, again, the administrator of the Bank Secrecy Act, issued additional guidance to highlight customer due diligence requirements

that might be pertinent to this type of activity. Again, this is clarification for financial institutions. They cover not only banks, credit unions, but securities brokers and dealers, money transmitter, etc., just 14 different types of financial institutions.

So, the bottom line is for purposes of marijuana, still a controlled substance. Banks are required to file Suspicious Activity Reports and Currency Transaction Reports. States, most states, have taken steps to legalize it or decriminalize it.

There's a difference between federal and state law. What we do is check for compliance with Bank Secrecy Act requirements, and risk management, as with all customer accounts.

So, I'd be happy to take any questions if you have any.

MEMBER DRENTLAW: I do. Minnesota is a newly recreational-approved state. One thing that we're struggling with a bit now is the delta

variants that are derived from hemp. Because they're derived from hemp, some say that they are still under that 0.3 percent THC. However, they have hallucinogenic effects and stuff.

And so, we're struggling with how, just because we have customers who are selling that. You can actually go into any liquor store and they have THC-derived delta variant drinks now. And it's becoming extremely difficult, to be honest, to monitor all these different businesses. Because every grocery store can have them.

So, there's questions in our board's mind how much -- how far do we have to go? Like how -- are they considered hemp, are they considered marijuana? And there's just very little guidance because everything is pretty old that we're trying to use.

MS. ARQUETTE: Not exactly an area where we specialize in making that determination. But as with any kind of customer who's making a

representation, it's not uncommon for a bank to double-check. So, if you've entered into a commercial relationship with a customer who is selling hemp products, we've seen banks request, you know, the documentation.

I understand that many, if not most, states have tightly controlled requirements related to hemp production. Things can change from one growing season to the next.

MEMBER DRENTLAW: I think it is dependent on the state. Minnesota is not. Okay, unfortunately, so.

MS. ARQUETTE: And if the state didn't have tightly controlled requirements and testing requirements, it would be up to each bank to, at account opening or depending on the risk profile that you've developed related to the customer, ask for documentation about crops.

But that would be a decision that a bank would make and that's what we've seen in the past. Because it can become difficult. It's the

same plant.

MEMBER RICHARDS: You make a statement FDIC encourages institutions to take a risk-based approach and not just decline to provide banking services to a category. But if a bank has in its policy that we will not knowingly bank cannabis-related or marijuana-related businesses, are you going to frown on us for that?

MS. ARQUETTE: A bank establishes their own risk tolerance. Often, it's based on, you know, the expertise of staff, what they can manage, how well they manage it. If a bank makes a choice -- in the AML space, anti-money-laundering examination space, no frowning.

MEMBER RICHARDS: Okay.

MS. ARQUETTE: No frowning. We just --

MEMBER RICHARDS: Because you hit the nail on the head --

MS. ARQUETTE: We just check for compliance.

MEMBER RICHARDS: We don't have the expertise. And with all the safe store businesses that we bank, we don't know that they might not be selling something related to that. But there's no way that we would know to monitor for that or if we knew they were doing it, what the rules are to.

So, we've made the decision in our policy to not knowingly bank any marijuana-related business. So that would be fine then.

MEMBER SHOEMAKER: And our concern is more if the examiners, you know, how hard are they going to come down on us. We have a very similar policy, but some of the examiners have come in with a hammer and said well, you know, you've always banked a commercial real estate developer. Did you know that that developer is leasing to a marijuana-related business?

And we just keep getting the investigation. It goes deeper and deeper. And the time and resources of our BSA department and

quite frankly my time, it's costly.

And so, I read this guidance and it makes sense to me. But we've risk-rated these customers. And our commercial real estate developer, he's doing what he's done for 20 years.

But we don't want to get in trouble or get our hand slapped when our developer is, actually his loan payments would be direct debited from his account. We don't get into his records, you know, and they're probably paying a check. Because it's legal in Mississippi to a certain extent.

MS. ARQUETTE: So again, we leave the risk tolerance up to each institution. As an example, not every bank will provide services to foreign financial institutions.

One, they don't have the bandwidth or they're unfamiliar with other jurisdictions, and so they simply are not going to provide correspondent banking services to a foreign

financial institution. That makes sense, right.

Similarly, if you don't have the bandwidth or simply it's not within the risk appetite of the bank's board to manage these types of relationships, that's simply a decision that the bank makes. And we'll check for compliance if you have marijuana-related business relationships, just with the Bank Secrecy Act requirements.

MEMBER REIGELSBERGER: As far as hemp is concerned, we don't currently have any farmers growing hemp. We did have one several years ago. The first year they said between the deer eating the hemp and then not having a source to sell it to, they said we're done, we're out. They're not going to do it anymore.

But I'm not saying -- looking through our state, we have a, the State of Missouri has got a website, I can go look and see. Now, everybody on that list is an LLC. I don't know who owns that LLC to say if they're my customers.

I think I would know because we're a small bank.

But if they're growing hemp, and it is very regulated on the state level, so if by some chance they mess up and it's got high THC, there's a cure for that. That cure is they destroy it. I don't know if thinking about a risk assessment as a bank, a whole, I mean, we've had very interesting conversations with between the auditors and the regulators about hemp.

I feel like it's a legal crop, and as long as they're following the rules and it's -- they're not being penalized or if there's not a problem with it, just like you would any other business, to make sure they're not having suspicious activity, then we're good to go.

But to have a special hemp section in our BSA risk assessment, I feel like that's maybe not where we needed to go. Because it's legal and there's a cure. Now, granted, if there's the cure and they don't do it, that's a whole different ball of wax that we've got to address

and file a SAR. I get all that.

I didn't know if there's any thoughts that you might have to share with us about hemp and like just the overall BSA risk assessment that we have.

MS. ARQUETTE: So currently a risk assessment isn't a requirement. It is a common practice that bankers use in all areas. We don't specify what you need to have in there. It's really driven by the customers, the product services, geographies in which you operate. Maybe even methods of payment, whether you use online banking, etc.

Just all of the characteristics, all of the attributes that kind of feed into what adds risk for illicit -- illicit financial activity. Hemp is not a controlled substance any longer. Not required in a risk assessment. Risk assessments aren't required.

So, it's really up to the institution to figure out its own profile of what it can

tolerate, how it can then use an internal control framework to manage the risk that you've identified in your -- that the process that you use.

MEMBER REIGELSBERGER: Okay, that's helpful, thank you.

MEMBER DRENTLAW: Sorry, I'd like another clarification just to Lily's point of having somebody who is renting a space. Or as this gets going, somebody who works for a cannabis shop that we didn't realize they did but had had an account for ten years, and all of a sudden we find out that they're working from -- we're struggling with how far does this go.

Like, how far do we have to start to or keep reporting on these businesses as it becomes completely legal in our state? Because I understand the Tier I, Tier II, Tier III. I mean, I think we'll end up being a Tier III by just definition because it'll be impossible to not ever have any money flow through the bank

that isn't somewhat related.

It's, where it's becoming difficult as we have for instance a farm, I called it a nursery some -- in a different meaning and somebody thought I meant a daycare. I don't mean a daycare.

But like a farm nursery, they have, you know, one side of their business is plants, shrubs, trees, that kind of stuff. They have a whole other separate business that does have -- then they intend to get into the marijuana-based.

Yes, they keep it separate, but how, you know, they're still going to have owners that have, even if we say we're not going to bank your marijuana-related business, that that owner has some commingling of funds at some point. And I'm not sure where it's -- where it stops.

So, what if our, one of our employees has a spouse that works. Do we have to report SARs on them because we know that their spouse is getting their income from an illegally --

federally illegal derived business?

And so, if there's any clarification, whether it's now, or that the FDIC or FinCEN or the FFIEC could give to states. I know I've talked to several bankers that they would really appreciate looking past just the guidance that is out there now, because it doesn't address all of those things.

MS. ARQUETTE: Thank you for your question. I would say that FinCEN's guidance was, I thought it was fairly clear in 2014. They did not address indirect relationships but rather the bank and the customer relationship.

You know, if however, you've got a customer relationship and it's a commercial real estate and the vast majority of its customers have businesses where they sell hemp, or maybe, you know, it's a business that involves funding, agriculture funding, production, selling, whatever it happens to be.

You know, I think many banks will look

at the proportion of the proceeds that come just from the business model itself, that FinCEN didn't go into detail or tiers in fact. They just indicated the direct relationship between the bank and the customer.

And when you develop for customer due diligence purposes the risk profile of the customer for other illicit financial activity, I mean, that would be an opportunity for you to kind of parse out what exactly the business relationship means to the bank so that you can monitor it and make sure that it is in fact what it was intended to be. Just like every other relationship.

Is it easy? Clearly it is not easy and it's getting more difficult. But FinCEN's guidance was very clear, it would be the bank's direct relationship with a customer that was engaged in a marijuana-related activity. I know that sounds like a non-answer, but that's as clear as they've been.

The FFIEC wouldn't separately interpret Bank Secrecy Act requirements on behalf of FinCEN, but I'm certainly happy to tee this up again for them, saying that there's difficulty in parsing out how far down the relationship, if there's a multi-tier relationship, a bank should go in evaluating whether or not some of the proceeds are derived from the sale of marijuana.

MEMBER DRENTLAW: That would be great. I think a lot of --

MS. ARQUETTE: At this point it's direct, but I'm hearing you.

MEMBER DRENTLAW: Yeah. And I think because so many states now have legalized it in some form or fashion, there's a lot more questions than there seems to be answers, especially as there are new states coming in and stuff. So yeah, any pull you have with FinCEN to give more guidance, that would be great.

MS. ARQUETTE: It's not uncommon for banks to file Suspicious Activity Reports on

indirect relationships depending on how they view the risk of that relationship.

MS. PEARSON: All right, are we good? Thank you very much, Suzanne and Lisa. Thank you all for an engaging discussion.

I believe next up we have Tom Lyons, Associate Director for the Division of Risk Management Supervision, and Luke Brown, Associate Director in the Division of Depositor and Consumer Protection. Tom will touch on commercial real estate loan accommodations and workouts.

He'll be followed by Luke, who will discuss guidance on third-party risk management guidance.

I will now turn it over to you, Tom.

MR. LYONS: Thanks, Nikita.

So welcome. Thank you for having me here to talk about the CRE workout guidance, appreciate that.

So, on June 29 of 2023, the banking

agencies and the NCUA issued a, the Interagency Policy Statement on Prudent Commercial Real Estate Loan Accommodations and Workouts. The statement was published in the Federal Register on July 6, and this is a principles-based resource for financial institutions to consider when engaging with borrowers experiencing financial difficulties.

So, this updates and replaces the interagency policy statement that we had issued in 2009 on the same subject. And given the myriad of challenges and risks facing the CRE lending, the agencies, in consultation with the state regulators, decided to update and expand upon the 2009 statement.

So currently more than 98 percent of the banks engage in CRE lending and CRE loans are the largest loan portfolio type for nearly half of all banks. Further, the dollar volume of CRE loans is at an historic high and it recently peaked at more than three trillion, $3 trillion.

Nearly 30 percent of banks have a concentration of CRE loans exceeding 300 percent of capital. That's Tier I capital plus the reserves. Or acquisition, development, construction loans exceeding 100 percent of capital and reserves.

So, in 2020, the COVID pandemic led to stress across several CRE property types, including hospitality, office, retail, the entertainment sectors. The office sector remains particularly vulnerable. Some borrowers, you know, may have difficulty refinancing, given the structural decline in the office demand that we've seen over the past couple years.

So regardless of the CRE sector, CRE borrowers' abilities to manage through a period of softer economic conditions, including supply chain imbalances, labor challenges, and geopolitical tension, inflation, rising interest rates, will impact the direction and magnitude of the risks in 2023 and beyond.

Lisa, can we move to the next slide?

So the new statement discusses the importance of working constructively with CRE borrowers who are experiencing financial difficulties and would be appropriate for all supervised financial institutions engaged in CRE lending.

The agencies recognize that prudent CRE loan accommodations and workouts are often in the best interest of both the financial institution and the borrower.

Accordingly, the statement reaffirms the key principles from the 2009 statement that financial institutions that implement prudent CRE loan workout arrangements after performing a comprehensive review of a 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 result in adverse credit classification.

And that modified loans to borrowers who have the ability to repay their debts according to reasonably established terms will not be subject to adverse classification solely because the value of the underlying collateral has declined to an amount that is less than the loan balance.

So, the statement adds a new section on short-term accommodations. Short-term and less-complex CRE loan accommodations are a tool that can be used before a loan requires a longer term or a more complex workout scenario. The statement reflects changes in GAAP since 2009, including those in relation to the current expected credit loss methodology, or CECL.

The statement also updates the original examples that were included and adds three new examples for multifamily, ADC for residential construction, and income-producing -- income-producing example for hotels.

The statement was issued for industry

comment in the fall of last year. We received 22 unique comments. And the statement was revised, you know, based on the industry feedback. Next slide, please.

So, you know, just as, you know, we held an -- on September 14, 2023, the Federal Reserve hosted an Ask-the-Regulator session on prudent CRE statement. And so, the speakers from there, all the agencies that were involved, FDIC, OCC, NCUA, we walked through the guidance, which included a deep dive into one of the examples to kind of walk through the thinking there.

The presentation had about 3400 participants. And we received a number of questions on that. But most of them were really case-specific, very specific scenarios about how the guidance would be viewed in that particular scenario.

So, the most common questions came up around, you know, accruals and non-accruals and when those need to be applied and reported.

Whether a particular workout scenario would be pass or adversely classified.

And also questions about an A/B note structure, which would be splitting the loan into two notes, you know, with one note representing the charge-off amount and the other representing the balance that was on prudent repayment terms.

So those -- that's a quick and dirty highlight of the CRE work out guidance. And happy to take any questions or comments that you have on that.

MEMBER SHOEMAKER: Do I understand it correctly that in some of these changes, that TDRs, for example, if you do an accommodation for a customer due to loan competition, a rate, that that is now classified as an adverse, a loan accommodation instead of really a competition issue?

MR. LYONS: Okay, so as this relates to a TDR?

MEMBER SHOEMAKER: Yes.

MR. LYONS: Right, so TDRs with CECL, you know, are no longer an item there. So, we removed that from the guidance as a consideration. But we're still looking at -- the guidance really focuses in on what -- how the examiners will be taking a look at -- and that's really how the, you know, all those examples are in a lot of the guidance, you know.

So, they'll be looking at the specific situation and how that, you know, applies to whether there's going to be an adverse classification or whether that would be passed.

And you'd be looking at the same things even before we get there, you know, so that you're recognizing the risk and rating that accordingly. And we'd be, you know, verifying that.

MEMBER SHOEMAKER: Thank you.

MR. LYONS: You're welcome.

MEMBER RICHARDS: You know, y'all came out with some guidance the other day asking I

think for comment on how you all were going to, I think change the Call Report.

You'd take the TDR language out of the Call Report, and you're going to replace it with modifications for borrowers experiencing financial difficulty. And so, there's a lot of questions about what that's going to look like.

But one thing I will say, I think you all learned, and I appreciate it, during the pandemic, it's almost as if you all took the opinion of you all know your borrowers and were able to work with your borrowers. You know them and you know the problems that they're having.

And you're exactly right. And I think it turned out to be very positive. I wish that same mentality would apply to other regulatory rounds as well.

But you know, my question and my hope, my advice would be is you all think of how you're going to define a modification for borrowers experiencing financial difficulty. That you keep

it simple.

I read in there that, you know, what about the duration. Well, it's going to be a minimum of 12 months potentially. And then there's going to have to be some sort of very detailed credit analysis of the borrower to determine if they're still in that financial difficulty, whatever that is, situation.

But this could be a monster of a thing, like CECL, which is totally unnecessary. Or it could be simple. And let's keep it simple, at least for community banks. We don't need another monster accounting thing to deal with.

MR. LYONS: I appreciate the comments. I'll pass those along to our folks in the -- that work on the Call Report in the accounting group. Because a lot of those things, you know, there's a lot of the accounting issues which also come into play, which can be complicated.

But I thoroughly hear you. Wherever we can be -- simplify things and make things

straightforward, that's always the best approach whenever we can.

MEMBER REIGELSBERGER: I think another addition to both comments might be as we do a lot of two- and three-year balloons for rates, you think about where we were at three years ago today, and now they're getting a rate increase of one over prime. And you're going from 4-ish to 9-1/2.

Sometimes in what we've kind of stumbled upon is it's not so much -- it's rate shock to them. It's not so much they can't afford it because they can. In their minds, that visual look of going up to say 9-1/2 percent is like they come in, oh my God, I don't believe this. I know rates have gone up.

So, in order to help calm them down so they don't go looking, which I don't know where they're going to find a better rate. Maybe, maybe, I don't. Probably Farm Credit services, they take a lot of that. They take a lot of our

farm loans away from us.

But in a situation like that, rather than see the loan walk, we're probably going to tweak their rate a little bit. And you know, just the rate shock in their eyes when they see that.

So that's kind of going back to your comments. I would not consider that a borrower experiencing financial difficulty. It's more of they can afford it, they don't want to pay it. But we kind of soften the blow for them a little bit.

If deposit rates can afford us a little bit of play there if we can take advantage of that too. So that's kind of adding to kind of what their thoughts are as we think about the definition that we're working on here.

MR. LYONS: Appreciate that.

MR. BROWN: Good afternoon, everybody. Thank you for having us join the CBAC meeting. As Nikita mentioned earlier, Tom Lyons and I plan

to walk you through the interagency third-party risk guidance that was issued last June. Slide two? Oh, we are on slide two.

Prior to the agencies issuing this interagency guidance, each of the federal banking agencies had issued their own separate guidance for managing third-party risks. The agencies generally had included the same principles in their guidances, but there were differences in scope and the number of examples.

However, with separate issuances of guidance on the same topic, some entities were unsure as to whether the guidances conveyed consistent messages related to third-party risk management. Slide three, please?

In developing the interagency guidance, the agencies sought to work together to make their guidances consistent, to articulate clear risk-based principles for third-party risk management, and considering feedback received, the agencies understood that because of the

increase in the number and types of third-party relationships, banks, especially community banks, might find examples of considerations useful in identifying and managing risks associated with a wide range of third-party relationships, and also for all stages of the lifecycle of third-party relationships.

So, in June 2021, the agencies issued proposed interagency guidance on third-party risk management in the Federal Register seeking public comment. Slide four, please?

In the aggregate, the agencies received over 80 comments for consideration in developing the final guidance. The FDIC, OCC, and the Federal Reserve Board reviewed and carefully considered public comments received, and issued final guidance in June of 2023.

Upon issuing the final guidance in June, each of the agencies also rescinded their previously issued third-party guidances. The final guidance provides a general framework and

a resource to assist institutions in implementing effective third-party risk management processes.

Banks use many types of third parties for numerous functions. All activities present some level of risk, so effective risk management is always important, particularly when a third party's engaged and provides services and conducts activities for banks.

The interagency guidance reminds institutions of this key principle. Whether activities are performed internally or via third party, financial institutions are required to operate in a safe and sound manner and in compliance with applicable laws and regulations, including those designed to protect consumers. Also, a bank's use of third parties does not diminish its responsibility to meet these requirements to the same extent as if the activities were actually performed in-house.

Recognizing that there is a wide variety of third-party relationships for varying

purposes, the guidance promotes tailoring of risk management practices commensurate with the risk profile, appetite level, as well as the complexity of the bank's third-party relationships.

And you might have -- so there are some similarities here obviously with the conversation with Lisa. I will now pass the baton off to my colleague, Tom Lyons.

MR. LYONS: Thanks, Luke. So, you know, the guidance is a principles-based resource and it's not mandatory. It's not a rule. The guidance is not intended as a checklist or as a safe harbor, so we do have those kind of questions that have come up in the past.

The guidance serves as a resource to assist institutions in implementing third-party risk management practices by providing examples of considerations in each stage of the lifecycle, the risk management lifecycle. So, those are planning, due diligence, contract negotiations,

ongoing monitoring, and termination.

So, the principles and examples of considerations addressed in the guidance are meant to be applied in a risk-focused manner, to take into account the level of risk, complexity, and size of the institution, as well as the nature of the specific, you know, third-party relationship, which kind of brings us to the next slide, Lisa, please.

So, tailoring, this is a key message throughout the guidance. If you've read it, you know, we mention it in several places. The institution can consider, you know, which activities discussed in the guidance within each stage might be appropriate for that institution depending on the situation, and can tailor its third-party risk management program to its specific relationships and risks and its activities.

An institution may need to incorporate, you know, different considerations

and factors such as those that may be found in more specialized, you know, topic-specific guidance to appropriately manage the risks from some types of third-party relationships.

So, you know, on governance, this section discusses the roles and responsibilities of board and management, the role of independent reviews, you know, to assess related controls and documentation, and reporting considerations, and to provide the necessary information for assessing the effectiveness of third-party risk management processes.

It highlights that the institution's board of directors has ultimate responsibility for providing oversight for third-party risk management and holding management accountable. Institutions are free to structure their third-party risk management processes in a variety of ways, as long as those processes provide effective risk management with accountability throughout the third-party risk management

lifecycle.

So, under the supervisory review section, this discusses how examiners will assess a bank's third-party risk management practices, but a key message here is that examiners will not examine to the guidance, but will evaluate the risks in the third-party relationships, the effectiveness of risk management processes, and whether activities are conducted in a safe and sound manner in compliance with all applicable laws and regulations, including those for consumer protection. So, next slide, please, Lisa?

So, here we have a number of resources that we believe are important and generally applicable to almost any situation when it comes to third parties, but, you know, we'll get into all of these, but they are on our website and here they are here. But a last point I do need to make is that business relationships with third parties engaged in lending, payment, or deposit

activities for the benefit of the bank or through the bank should be evaluated using, you know, both third-party risk management guidance, you know, a lot of good things in there to consider, as well as the various risk management processes and rules and regulations that apply to traditional lending and deposit relationships.

Now, relationships that are only between banks and their direct customers of traditional bank products and services such as a depositor, or retailer, or commercial loan customer, would not be addressed in a third-party risk management framework.

Those are covered by various risk management processes and rules that apply to traditional lending and deposit relationships. You know, you all have, you know, your traditional underwriting standards that you'd like at. And with that, you know, we're happy to take any questions or comments that you have on third-party guidance.

MEMBER MAUST: Thank you for covering that. I appreciate the agencies in a joint basis issuing guidance to the industry. It's been a topic of growing concern, I think, from institutions that are engaging in relationships that are outside of legacy service providers, and I think we're going to see more and more of that in a variety of different forms, not just in, you know, one way, but those that are more innovative, either direct to market, so market facing, or behind the scenes assisting banks in novel ways that aren't provided by definitely the legacy providers. So, this is very helpful.

I think the one comment you made or characterization you made was spot on, and I think it's written here somewhere, but treating it as if we're conducting the activities ourselves, is there a way to then ensure that if somebody's doing it in an outsourced form, that we can make sure that those activities are being conducted as if we were controlling all the way

through?

One of the challenges I've seen in banking, the so-called banking to service, which I'm not a real fan of that nomenclature, and I think that type of business model of handing off is probably not healthy for the industry, but working in a joint way in an embedded banking fashion probably is when we're talking about real economy participants.

One of the real challenges that I've seen in that space has been the handoff of responsibilities to a third party. So, in having, you know, kind of going through this, I noticed it pulls it back in and really looks at it, and says okay, if we're going in a joint basis to market or we're strategically aligning with somebody, that the bank needs to control, almost in a supervisory fashion, the process all the way to the end customer as if it's your own end customer, and I suspect that's -- is that a position held by the FDIC as well when we think

about field examiners on site?

MR. LYONS: So, you know, the bank really does need to understand, you know, all of the ramifications of the contracts that it enters into and the relationships that it's in, because ultimately, it's going to come back to and reflect on the institution, right? So, you know, one of the things we tried to walk through in the guidance, I think -- you know, I've been living this for too long.

You know, to me, it's almost kind of intuitive for business folks, you know, plan out what you're going to do, understand why you're going to do it, you know, do your due diligence on your partner, and in the activity itself, what does that mean for the institution and what are the goals that are going to meet the goals of the institution?

And then, you know, as you're putting this through, and I know I'm kind of walking through these things, but I think they're really

important, you know, to think about it before you get involved in the relationship, how that all comes back and how is the institution going to oversee that? Do you have the expertise? Do you understand who your partner is and, you know, have the ability to get the information that you need, you know, to understand how they're doing that?

I know that we've had instances where third parties have kind of gone off track and the bank hasn't necessarily picked up on that, and yet it reflects back on the institution. So, it's very important to know those things.

Can you know everything that's going on if they're not going to tell you those things? I think that's a challenge, right, but there are ways that you can kind of put things in place and make those expectations, you know, known right up front.

What the examiners are going to be looking for is how does the approach that

relationship? Have you done your due diligence? Have you, you know, documented what you needed to do? Have you done what you could as far as from a contracting standpoint, a monitoring aspect, and reporting that up, you know, to your board and to senior management, and when things need to be elevated, you know, bringing those, you know, forward. You know, it's those kind of things that I think are really important.

Another thing that we highlight in here, which I think is also important but doesn't get as much attention as it maybe needs, is when you need to end that relationship, what happens then? Who owns the data? How do you, you know, back out of that and go forward?

But it's also important from a contingency, you know, aspect. And Suzie was talking a lot about the contingency and I know you brought up the reciprocal side, understanding how things impact the institution when things need to change. So, I don't know, Luke, if you

want to add?

MR. BROWN: Yeah, there's not much I can add to that. I'll just say, so I think the guidance provides a really helpful framework that applies across a huge range of types of relationships, and I think it starts with the way you asked your question.

You know, if the bank understands at the end of the day, despite being in a relationship, they're required to be consistent with safety and soundness, and laws and regulations, including consumer protection laws and regulations, then the bank steps back and says well, that's my level of obligation and I should be focused on these issues.

And I would also suggest that I think that sometimes in terms of getting involved in third-party relationships, institutions are more focused on their front end of the process as you're bringing in and you're vetting the third party, but that's got to be a lifecycle approach

throughout the relationship. There could be different changes and you want to understand what's going on under the hood essentially, so that's what I would add to the discussion. Thank you for the question.

MEMBER RICHARDS: Thank you. I had a question. I understand this guidance has to do with our responsibility for third-party management. I have a question. Mainly, I guess you could say it's what FDIC's responsibility is for third-party risk management.

We report to FDIC our people that we have relationships with, our vendors, and I know we get reports when you all examine the Jack Henry's and the Fiservs and the Finastras, the biggies, but how far down the food chain does that go for all of the Fintechs that are out there?

And what I'm getting at is if there's a situation that a bank has with a particular third party, it may be a Fintech, and it's a bad

outcome, a bad situation, is there a way that we would get notified about that, if they're in the financial services ring, that we'll know not to go there or is there privacy concerns that, you know, that won't let you do that? How far does you all's responsibility go to keep us safe when there's bad actors out there that are having these relationships with banks? Does that make sense?

MR. LYONS: I think so. I'm not an expert in the Bank Service Company Act, so I might need to, you know, reach out to a friend, but --

(Laughter.)

MR. LYONS: -- some of what you're asking for relates to, you know, our authorities under the Bank Service Company Act.

MS. ARQUETTE: Thanks, friend. So, in terms of significant service providers like the one that you mentioned, we work with the other federal banking agencies and we jointly examine the service provider. We evaluate the service

that's provided to institutions.

To the extent that maybe we believe the findings need to be shared with client institutions, we will push out or offer the Report of Examination to client institutions, and that would mean if there's something that we think you need to know. So, it may not be highly rated, but there could be problems that relate to possibly the ability of the service provider to provide services at some point. That helps you to assess --

MEMBER RICHARDS: Sure, sure.

MS. ARQUETTE: -- your contingency plans, but in terms of other types of service providers, we evaluate regional service providers, those that provide services and are significant to institutions that we supervise in geographic areas, and we do only go so far, you know, just in terms of resources.

MEMBER RICHARDS: I just kind of wonder what that --

MS. ARQUETTE: What the threshold is?

MEMBER RICHARDS: -- cutoff level, that threshold, size-wise or --

MS. ARQUETTE: Importantly, we're focused on the ability of an institution to continue operating. So, for instance, if you have your core services provided by a service provider, if you will, and something that is affecting that core service provider could cause you to no longer be operational, whether it is malicious, an outside event that's malicious, or an event, a weather event, or some other type of just issue that happens with that service provider, if it's within our portfolio, we would certainly notify client institutions, so the banks that get their services from that core service provider.

We are exploring additional ways with our counterparts from other agencies to do this a little bit differently because we recognize that a lot of complexities have entered into the

financial system, who you're working with and what becomes critical to an institution, and there has been a lot of, you know, vendor relationships, outsourcing, et cetera, so we're working with our partners to see how much we can do.

Could I add one more comment? In terms of the issue that you brought up and the term that you don't like to use, which lots of people don't like to use, but entering into a third-party relationship when that third party facilitates relationships on behalf of the bank, whether on the deposit side or the lending side, we've seen that that can go poorly on the Bank Secrecy Act / Anti-Money Laundering side in that the third party might generate a lot of account relationships.

There may be a master agreement in place where the bank relies on that third party to collect information at account opening. It's always worth double checking and making sure that

it's happening.

The regulatory requirement is the bank's regulatory requirement if the third party is not collecting it. Sometimes there are streamline processes that are not consistent with the customer identification program requirements.

The bank should, you know, just double check periodically, due diligence on your third-party relationships. So, that's where we've seen some interesting streamlining by third parties, not by banks intentionally, but by third parties, so always important to double check.

MEMBER JAMES: Very quickly, I think this is very interesting. I wanted to push a little bit on Troy's comment, and the Chairman may recall this. A few years ago, we had some discussion with FDIC around whether it would be appropriate for the FDIC or the other regulators to sort of create a green list of Fintech companies that would be okay for us to use.

You know, we may not have, you know, extensive staff that can evaluate, you know, these technology companies and dig into their algorithms. They may not allow you to actually see the algorithm to show you how they're selecting customers, for example.

I don't want to get to the point where we're not taking responsibility for the relationship. So, to the point that you're making, I mean, we still are ultimately responsible for these relationships, whether it's a lending or depository relationship, but I do wonder, however, if it is, if maybe the FDIC can't create sort of a list of players that have passed, you know, whatever the criteria are.

Perhaps there's a way for you to tell us which ones are creating problems so that we know to steer clear, you know, and make sure that we're not running into BSA/AML compliance issues when those issues have been caused ultimately by a contractual -- you know, you enter into a

contract with the Fintech.

The Fintech is supposed to apply the regulation according to the standard by contract, but however, we're still -- we're regulatory obligated, so our obligation is a higher-level obligation, but if there's a problem, we may or may not know about it, and I think that's where, you know, I'd be interested to know if there's a way for us to create -- you know, keep us informed, keep us aware.

MEMBER RICHARDS: That's what I meant to ask.

MEMBER JAMES: Yeah, yeah.

(Laughter.)

MEMBER SHOEMAKER: And essentially you're asking for a TSA PreCheck.

MEMBER JAMES: Yeah.

MEMBER SHOEMAKER: You still have to go through security.

MEMBER JAMES: That's right. That's right.

MEMBER CAMPBELL: Yeah, I --

MEMBER JAMES: I love that.

MEMBER CAMPBELL: I like the idea of the red list. I don't like the idea of a green list, you know, but I think, you know, a lot of times too like with the banking associations that we're part of, they do a lot of this type of work as well working with Fintech and vetting some of those things. So, I think that's a great resource for us, but I definitely wouldn't want FDIC picking the green list, picking the winners.

MEMBER JAMES: Right.

MEMBER CAMPBELL: But it would be nice if we were aware of the losers and didn't even go down that path.

MEMBER MAUST: We talked about a shared assessment model. I think that was a couple of years ago. Yeah, the industry would have a joint cooperation with the public sector as well.

I did want -- and the bank secrecy, or

the Bank Service Company Act is pretty limited in scope. I think at one time, it was a very wide scope in relation to what banks consumed as far as data processing and other third-party service provider relationships, but it's become a pretty small, narrow scope relative to all of the other services that are provided to banks.

So, it's unfortunate that they don't fall under the umbrella for supervision by federal function regulators or agencies. That sure would be nice for us. So, it might be incumbent upon us to take that on.

I did -- I thank you for bringing that up regarding BSA. And I don't mean to just pick on BSA, but having been through -- and it took us two years of just corporate governance, risk management, planning, build-out, and hiring before we even opened our very first account with a small program just to see how it would go.

We audited 100 percent, and did for quite some time, of every single opening as if it

were happening at the branch. And I think what we have to remember is any novel provider to the banking industry -- legacy providers, it's totally different, but novel providers are like hiring a brand-new employee out of college.

They don't know what they don't know and they don't understand banking, certainly not to the extent we do, and they don't have an appreciation for why things are the way they are, and so it's incumbent upon us to make sure that every single one of those activities is compliant and under control. So, thanks for bringing that up because I didn't want to discount that.

MR. PEARCE: Yeah, I've been sitting here for like an hour, so I felt like I had to start talking at some point.

(Laughter.)

MR. PEARCE: So, you know, I think on green lists and red lists, I wouldn't expect us to do that anytime in the near future. I understand the rationale for wanting to have one,

but when we look at our authorities, right, so we have the authorities to supervise state non-member banks and do that supervision, and the third-party risk management guidelines that Tom and Luke talked about, provide some resources for you to help manage those third-party relationships, but we really rely first and foremost on the bank to do it, right?

The Bank Service Company Act, as Lisa talked about, you know, we do have some authorities there and we have a program related to that, and that is certainly an area where we're probably increasing our intention. So, on the consumer protection side in particular, some of the issues that we have seen that have caused consumer harm have been related to some deficiencies with a third party, and so this is certainly an area that we're paying attention to and expanding our work, but we don't have the resources, or capability, or the regulatory authorities over some of the Fintechs and the

non-banks directly, so I don't think that's really going to be in the scope for us certainly in the near term.

MEMBER RICHARDS: Well, let me push back just a second on that. And I understand where you're coming from, but if there's a bank that had a relationship with a Fintech and there was some incident, a bad incident that took place, that bank is probably going to report it to FDIC in some form or fashion, whether it's through a SAR or just picking up the phone and calling FDIC and saying hey, we had this bad thing happen, and you knew that there were any number of other banks that were also customers of that Fintech, would you all not think it incumbent upon yourself to make some sort of notification to the other banks or not? I mean, I'm just asking.

MR. PEARCE: So, speaking on that --

MEMBER RICHARDS: I would like to know that.

MR. PEARCE: Certainly, on the consumer side, when we have identified situations where there may be a third party involved, one of the things we do look to see is do we know if that third party is working with other FDIC supervised institutions --

MEMBER RICHARDS: Okay.

MR. PEARCE: -- so that we can do the appropriate follow-up work. Each of these scenarios are going to be a little bit different, but we do try to connect the dots, at least as related to our supervision program, but there are lots of issues around notifications of banks regarding what we found in other supervised institutions, especially if our authorities are not clearly related to the third party.

So, it's a pretty complicated area, but certainly understand that we are living in a world where there's a lot more partnerships or arrangements between third parties, non-bank third parties and banks, and so it's an area that,

you know, we're continuing to look at our authorities in this space, and from an operational perspective, how can we get better at seeing those intersections as third parties are working with multiple supervised institutions? So, I definitely am sympathetic to the point and it's an area that we continue to look at.

MEMBER RICHARDS: I take what I get.

(Laughter.)

MEMBER PERRY: I can see where it would be hard for the FDIC to be, you know, policing all of the third parties, but we might also look to our state banking organizations to do that for us. So, I feel very blessed to be in Kentucky where we have a very strong state banking organization, the Kentucky Bankers Association, and, you know, they endorse vendors.

So, you have to go through a process of being approved to be an endorsed vendor, and it's not just vendors within Kentucky. It's vendors across the nation. So, you know, that

might be a good place for us to look.

That doesn't relieve us of our responsibility to do our due diligence on these third-party vendors, but at least they've gone through an initial check through our state banking organizations. So, that, I think that gives me a little peace of mind before I start doing my due diligence, so.

MR. BROWN: And I'll just add a couple of thoughts. You know, one thing that we haven't quite touched upon is that the agency does a lot of work in terms of understanding the companies that are out there, and their tendencies, and their relationships, both on the policy side and examination side, because we want to make sure that we're educating ourselves.

And again, our focus is derived through our authorities through banks, so that's -- much of what you see here is from our understanding what's going on out there and then sort of processing the information, sort of what

are the risks and what can we communicate?

And also, you know, we have a lot of relationships with other regulators with different authorities. So, if we find an issue, whether it's a violation of law or some sort of concern, we certainly would refer that item to another regulator that would have the authority to address that issue.

MS. ARQUETTE: So, if I might, Nikita, I would add in the Bank Secrecy Act / Anti-Money Laundering space, when we're aware of a relationship where a third party has streamlined their process, thereby causing the bank not to be in compliance with regulatory requirements, including suspicious activity monitoring, or customer due diligence, or collecting information at the beginning of the relationship, the customer identification program, we'll notify the institution, you know, and we have seen these third parties go to other financial institutions. We will work with our staff in other regions to

focus and ask the same questions, thereby working with the institution to make sure that they are, in fact, meeting their obligations.

So, as Luke said, we do that internally as an agency with other agencies, and as appropriate, refer matters to the Financial Crimes Enforcement Network so they can focus. They have much wider authority in the Bank Secrecy Act space and can work with other federal functional regulators.

MS. PEARSON: All right, thank you very much to the panelists, and thank you all for the engaging conversation. We'll move now to Lance Jameson, who is product owner for FOCUS, which is one of our systems of record.

Lance works in the Division of Deposit and Consumer Protection. Lance will provide us an update on the banker engagement site. After Lance's brief update, we'll move to Mark Pearce.

MR. JAMESON: Thank you, Nikita. As a product owner for our system of record, I just

basically represent the business side and the modernization effort for our system of record, providing business requirements to our vendor and our IT specialists as we go through our modernization effort.

Today, I'd like to share with you a product that we just deployed in September known as our Banker Engagement Site. As we were developing our new module for our pre-exam planning module, we identified an opportunity to create a new banker portal that would facilitate the compliance and CRA examination activities. So, today I'd like to share some of that information.

We launched the Banker Engagement Site on September 7. We do think there's going to be great efficiencies in the exchange of documents, information, and communication, both benefitting the examiners and the institutions.

The pre-exam planning process generally starts 90 to 120 days before the

examination process. There's several components. There's an information package, a pre-examination questionnaire, a compliance information and document request, and a transactional testing request. All of that information that's exchanged between the institution and our examiners helps us set up the scope of the examination, so it's critical to our planning process.

We also, within this Banker Engagement Site, have an ad-hoc capability. So, outside of the pre-exam planning process, we can share documents and information between the bank and the institution.

So, examples of ad-hoc would be maybe during the, later in the examination cycle, maybe there's some additional documents that we want to securely share, so those could be processed through the Banker Engagement Site.

Outside of the examination cycle, there are times when banks reach out to our

examination teams to talk about third-party relationships or new disclosures, so those types of communication could also be facilitated through the Banker Engagement Site.

So, earlier this year, we engaged with a vendor to conduct banker usability testing for the Banker Engagement Site. We had nine institutions from across the country, ranging from $180 million to almost $15 billion.

And the vendor led them through a series of exercises and communication, bringing them into the application and asking them to complete tasks. They intuitively were able to complete the task based on the design, the user-friendly design of the application.

They appreciated the transparency in identifying where they were in the process of completing the component or completing the overall pre-exam planning process, and the ability to upload documents and associate them with specific request items was helpful, one or

more request items. It took some of the pain points from the existing process away from the sharing of those documents.

The bankers also shared a number of ideas with us for enhancements. We were able to address those during our development and finish a couple of others over the recent weeks. Some of those included placements of some of the features, others label changes for clarity, but I think we will continue to seek feedback from the bankers as we roll this out and make changes through our agile development process.

The banks will also have the ability to opt out, so choose not to use the Banker Engagement Site. In those instances, we will, the exam teams will talk to the bank and address that through another sharing process, for instance, the Enterprise File Exchange, EFX, that's currently used.

We may still use EFX for some other examinations that have an extreme high volume of

sharing or sharing with state examiners or RMS for some of the joint activities. Let's see, can we move to slide two? Thank you.

As far as communication, an FIL was issued in early September, FIL-49-2023, and that provided the awareness that the Banker Engagement Site was, the impending release of the site. We've had -- this is a week or so old, but, you know, we probably have well over 100 bankers that are enrolled in the Banker Engagement Site at this point. Something like 30 or 40 institutions have a full team in the Banker Engagement Site.

We've initiated 25 pre-exam planning activities with bankers, and at least two as of yesterday have completed the pre-exam questionnaire in the Banker Engagement Site. Next week, we'll reach out to our examiners that have been working with the bankers to see if there is some early feedback from that process.

We do have user guides and job aids that are available in the Banker Engagement Site.

We'll continue to maintain those training resources current as enhancements or changes are made or if training needs are identified by bankers. There's also help desk numbers that are available for banks to call for assistance.

We have briefed and demoed the Banker Engagement Site with the staff, some staff from the ABA and ICBA. They've shared some information, I think, with the state associations after those briefings, and if there's additional information that they need for state associations, they'll be reaching out to us and we'll be providing additional information as needed.

Earlier this week, we recorded a short video, I think it's eight or ten minutes long, that gives an overview of the Banker Engagement Site. That will be available on the FDIC site under the Banker Resource Center, and we'll be sharing that with our regional field management so they can do outreach, and as they reach the

institutions to start the exam process, share some resources so they have an understanding of the Banker Engagement Site the first time around.

So, the Banker Engagement Site, again, is compliance and CRA activity for pre-planning. RMS will still use EFX for their document sharing process.

And so, it's a brief update, but we really just wanted to give you an awareness of some of the terminology that's going to be coming out. We're looking for feedback and ideas, and hopefully it's a great experience for the bankers that use this new tool.

MEMBER SHOEMAKER: In regard to the ad-hoc communications, will this become a part of our permanent record or will it purge after so many days or months?

MR. JAMESON: Yeah, the ad-hoc record will, if it's related to an examination, it would fall likely into the workpapers and part of that retention process. If it's a communication, it

would fall under our communication rules and be retained under our communication retention plan.

MR. PEARCE: One of the things, just to jump in, here is this, is something that we're hoping will really be a win-win, both for our examination teams and for the bankers.

On the consumer compliance approach, our exam approach, we've shifted over the last decade to doing much more work in the pre-exam planning part where we do risk scoping to really focus on the areas where we think there would be a risk of consumer harm, and so a lot of our examinations are now occurring off-site, you know, and then we have an on-site portion once we scope the exam.

And every quarter, I get a report from our ombudsman that does the post-exam survey and gives us feedback that bankers have provided over the course of, you know, at the end of the examination, which is completely anonymous, by the way, and I don't know who does it, but it

gets compiled and I get statistics and information through it.

But one of the things that's really been a pain point for bankers on the consumer compliance side has been there are a lot of questions in the pre-exam process on the consumer side, and there may be a lot of documents that get requested in advance, and so that's kind of been a pain point.

And I think the Banker Engagement Site, I think the long-term vision for this site is it will enable an easier flow of information and ability to, you know, down the road, be able to have more information that's kind of pre-populated that might not change from exam to exam, and hopefully will make that pre-exam planning process more efficient and remain as effective as we need it to be. So, that's a goal. So, we're still working toward that, but this is step one.

MEMBER DRENTLAW: Is there any thought

to extending that to the safety and soundness side? Because, don't get me wrong, the compliance exam, it is extremely thorough, but even on the safety and soundness side, there's a lot of repeat questions in the officer questionnaire.

It would be nice to be able to link documents with specific questions because they get lost sometimes, so we have to re-upload stuff. It sounds like a great site that could be really utilized well on the risk management piece.

MR. PEARCE: We're first out of the gate on this. We've been undergoing a modernization of our internal systems for the consumer compliance process for our examiners, and my colleagues on the safety and soundness side are embarking on a similar process, but at a later phase. And so, hopefully some of the lessons learned from our development work will be useful in their development work, so that's

probably down the road a bit, but certainly on the agenda.

MR. JAMESON: And we are actively talking with that team about some of the common capabilities in the portal and the questionnaire to facilitate that exchange of information, and have that transparent and available, not only prior to the exam, but, you know, for the next cycle of exams are all things that they are very interested in and seek common value.

MR. PEARCE: All right, Nikita is giving me a look, so I guess I've got to check my watch. So, the last thing we wanted to talk about is our return to banks process.

About a year ago, we shifted from the pandemic footing to beginning to come back onsite at institutions. And maybe as a backdrop to that, on the consumer protection side, I just sort of talked about how we have moved over time to having more off-site work in the pre-exam planning process.

And so, pre-pandemic, we were about two-thirds off-site and one-third on-site, and obviously during the pandemic, we were 100 percent off-site, and as we over the last year have been kind of coming back into banks, we're somewhere in between, so we're 20 or 30, you know, 20, 25 percent on-site.

And so, we're really trying to work through the process to make sure that we're finding sort of the sweet spot of, you know, making sure that we have on-site presence and still utilize off-site capabilities to make the exam process efficient and effective.

On the RMS side, the safety and soundness side, sort of pre-pandemic, it was about 40 percent that was off-site and, you know, more of that on-site activity. And, you know, so we have been coming back into the banks and we wanted to at least take the opportunity at the end of this meeting to see if you had any feedback regarding that transition to having examiners

back on-site at the bank, or if there have been any new challenges or things that we need to take a look at now that it's been about a year.

MEMBER RICHARDS: When I saw this title, I got excited. I thought this was going to be a return of insurance premiums back to --

(Laughter.)

MEMBER RICHARDS: I think for us, I'm always a face-to-face person, but, you know, truthfully, I think a hybrid approach works really well for us. A lot of the stuff, we can send and it's self-explanatory, but a lot of it is not and you need that eyeball to eyeball sitting across the desk from somebody part of it and -- because, you know, banking is not just data.

It's relationships, and sometimes we need to explain those relationships, and so I think face-to-face, I don't want to give that up, but, you know, I don't mind sending in a lot of the data either.

MEMBER HORVAT: I would agree with Troy's comments. I think pre-pandemic, it could be extensive. I mean, there were points where we thought we had some additional employees, but they were FDIC examiners, and I think we actually had a pretty good balance the last exam we had with on-site and with off-site. I think it can work both ways.

MR. PEARCE: Great, thanks.

MEMBER DRENTLAW: I think we -- oh.

MEMBER PILARSKI: Go ahead.

MEMBER DRENTLAW: We had an exam last October, so it was one of the first on-site exams I think the examiners had been on for a while, and I concur. It was nice to not have our entire parking lot full of additional cars.

So, the hybrid was great, but the relationship that you can build with the examiner face-to-face, I think, is extremely important, because there were times that, in the off-site exams only, that assumptions would be made and it

would not be brought up until the end of the exam rather than just having that conversation, and even just talking about families and stuff, it makes everything a little bit more relatable, so I think having people back in is a good thing.

MEMBER PILARSKI: I would agree with all of those comments. The one pain point on the safety and soundness is sharing imaged loan files. We see a lot of value to them getting those off-site, but we don't have -- somebody help me out, is it FIVE? And we've talked to our core and it would be very expensive for us to get that, so if there's some sort of alternative there, that would be very helpful.

MR. PEARCE: Yeah, I can tell you we're continuing to look into that area because we know a significant percentage of banks don't image loan files and getting those files to us is challenging, and, you know, looking at technologies and strategies to do that is still something that we're working on, and we've got

some technology people that have a lot of great ideas, and so we're trying to figure out if we can make those into reality.

MEMBER CAMPBELL: What I found most beneficial through the virtual exam was time management, and so your staff seemed to do a really good job of learning to manage their time in bringing a pre-list of questions and then scheduling time for that as opposed to, you know, when they're in the office, it's just quick access, and so it could be all day --

MR. PEARCE: Back and forth.

MEMBER CAMPBELL: -- you know, and so I think if they can, you know, take what they've learned through the virtual with, you know, scheduling time, that was very beneficial.

MR. PEARCE: Great, thanks for that.

MEMBER HUANG: I piggyback pretty much what everybody else has said. The pre-exam stuff has really helped a lot, I think the fact that we can, if the FDIC is able to give it to us 90 days

out, we're able to give it to you early.

Your examiners have time to digest everything, and from day one, they can come in just with substantive questions. Then we're able to clear up any kind of misunderstandings so that we're not at the end of the examination having an exit meeting and we're still trying to explain, you know, certain things that we probably could have cleared up if we were face-to-face.

The hybrid has really worked well for us. We don't have that many C-level executives, and if, you know, there are 15 people from the FDIC, it almost feels like a three-on-one five days a week, and that wasn't a lot of fun to be honest, but the fact that we can kind of hybrid it then, you know, plus for our office space management, it works out well too, so.

MEMBER MJARTAN: If I could add, I agree with most of the comments, but one thing I would point out is we recently had a visit from the regional office in Atlanta, and we're in

between exams, and it was really nice to have them on-site, especially now that we're in a little bit of an uncertain environment, having those conversations in person and for them to make the trip, make the effort, and then spend a couple of hours on-site was extremely valuable, and I encourage them to do that.

We try to do that quarterly anyway with both the case manager and also the regional director or the assistant regional director. In terms of the exam, you know, we're a small bank as well, but I would advocate, like I think I did last time, just for as much on-site time as is manageable for both. It was a much more productive exam for us to have that relationship.

MEMBER HORTON: I would just like to add that our experience with the FDIC examiners has been so appreciated that there's a lot of, you know, continuity, experience, retention of examiners more so than at the state level has been our experience.

And I think, you know, the communication has been great whether it's been hybrid, in person, or remotely, and I think it's that experience of the examiner. So, whatever you're doing to retain good people, keep it up, because we notice the difference, and we would love to --

(Laughter.)

MEMBER HORTON: -- have that experience with examiners any day than inexperience. So, they really understand risk management and how to put things in perspective, so thank you for that.

MEMBER DRENTLAW: Just to follow-up on Troy's comment, for the exam that we had when they were back on-site, I noticed exactly what you were talking about, where they were really good at, again, saving up a list, asking for time to sit down ahead of time instead of just driving by and stopping in. So, it seemed at least the team that we had on-site had taken that

experience that they had had during the pandemic and brought it forward.

MEMBER JAMES: We have an exam that just kicked off, so I'll let you know.

(Laughter.)

MEMBER JAMES: I do know that we were forewarned that we were getting a lot of trainees, which makes us nervous, quite frankly, to have extra people because we're so small that, you know, when we have a lot of extra people and they have to sit there for a couple of weeks, well, there's a lot more time, you know, for them to go and nitpick, frankly, you know, and so that has been a big concern of ours.

So, we'll let you know, you know, how it goes when they come on-site. I think they start on-site next week if I'm not mistaken, so we'll see, but we've been -- the pre-work has been pretty extensive this time, so, you know, hopefully it will be a very substantive and constructive visit.

MR. PEARCE: Thanks. You know, all of the experienced, talented examiners we have, which is, I think, a terrific resource for the FDIC and something we're proud of, you know, we have to start somewhere, right, in training, and a lot of folks during the pandemic, they came on board and we had training, and they haven't had the opportunity to go on-site.

And so, some of that, kind of getting back on-site and having those positive experiences and conversations with bankers is really an important part of our training program and development. So, understand that there may be some challenges that come from that, but it's something that is pretty important for us to be able to develop our team and then be able to provide that kind of comprehensive and capable examination that I think we care so much about.

And I guess I should have probably mentioned it at the first part, and I really appreciate all of the feedback from you on this

because it really reinforces and validates a core for us, which is the importance of the on-site portion of the examination, that we're very committed to that.

We think it adds a lot of value for the examination to be a constructive process, and I think what we hear from bankers is they get a lot of value from that too. And so, we know you don't want a whole parking lot of people for extended periods of time, and so we're really trying to refine that and calibrate it to make the hybrid approach effective and efficient, so thank you. I'll turn it back over.

MS. PEARSON: So, we are wrapping up the meeting. There's a couple of points I would like to make briefly. First, thank you all very much for your time and engagement today. I wish you safe travels.

I would like to thank Lisa Roy for all of the work that she did today. Thank you to the IT team in the back. And I know there's a lot of

team members who are outside, Shannon, Roz, and a lot of other team members. I really appreciate their help.

I want to thank Cassia Rodrigues, who is a Master's in Applied Economics student at University of Maryland, for joining us today. She has an interest in networking and increasing her knowledge, so if you have an opportunity, please make sure that you say hi to her before you leave.

And before I turn it over to the Chairman, Vice Chairman Hill, are there any closing remarks that you would like to make? All right, Chairman Gruenberg?

CHAIRMAN GRUENBERG: Thank you, Nikita. We're right on time, so I'm going to try to stick to that. Let me just say a brief word of thanks to all of you for your thoughtful and candid comments really throughout the day today. We're very appreciative. This committee really brings a lot of value to the FDIC, so we really

thank you for your time and commitment.

I'd like to say a final word of thanks to the five members of the committee who will be leaving us and this is their last meeting, Mike Bock, Chief Executive Officer of Dairy State Bank in Rice Lake, Wisconsin; Hal Horvat, President, CEO, and Chairman of the Board of Centreville Bank in West Warwick, Rhode Island; Cindy Kitner, President and CEO of Jefferson Security Bank in Shepherdstown, West Virginia; Arlen Osterbuhr, Chief Executive Officer and Chairman of the Board of Minden Exchange Bank and Trust Company in Minden, Nebraska; Shane Pilarski, President and CEO of Alliance Bank in Francesville, Indiana.

I should mention also Andrew West, who couldn't be here today. He came down ill. He's the President and CEO of Eagle Bank of Polson, Montana, who will also be leaving us. Thank you all. It's really been a pleasure. My thanks to everybody. We'll see you next time. Take care.

(Whereupon, the above-entitled matter went off

the record at 3:00 p.m.)