FEDERAL DEPOSIT INSURANCE CORPORATION

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ADVISORY COMMITTEE ON COMMUNITY BANKING

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MEETING

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THURSDAY
NOVEMBER 7, 2024

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

PRESENT:

MARLENE BARKHEIMER, President and CEO, Farmers State Bank, West Salem, Ohio
THOMAS BATES, President and CEO, Legends Bank, Clarksville, Tennessee
TROY CAMPBELL, President and CEO, Altoona First Savings Bank, Altoona, Pennsylvania
CAROLYN CROCKETT, President and Chief Credit Officer, First Security Bank of Nevada, Las Vegas, Nevada
MICHAEL CULHANE, President and CEO, North Cambridge Co-Operative Bank, Cambridge, Massachusetts
LLOYD DeVAUX, President and CEO, Sunstate Bank, Miami, Florida
ANITA DRENTLAW, President and CEO, New Market Bank, New Market, Minnesota

SUSAN HORTON, President, CEO, and Chairman of the Board, Wheatland Bank, Spokane, Washington
WARREN HUANG, General Counsel, Amerasia Bank, Flushing, New York
TREY MAUST, Executive Chairman, Lewis & Clark Bank, Oregon City, Oregon
DOMINIK MJARTAN, Vice Chairman and Executive Committee Member, OPTUS Bank, Columbia, South Carolina
APRIL PERRY, CEO and Chairman of the Board, Kentucky Farmers Bank Corporation, Ashland, Kentucky
NORMAN PLUMSTEAD, President and CEO, Honor Bank, Honor, Michigan
KIM REIGELSBERGER, President, Preferred Bank, Rothville, Missouri
TROY RICHARDS, President, Guaranty Bank & Trust Company, Delhi, Louisiana
LILLOUS ANN SHOEMAKER, President, Magnolia State Bank, Bay Springs, Mississippi

ALSO PRESENT:

MARTIN J. GRUENBERG, FDIC Chairman
TRAVIS HILL, FDIC Vice Chairman
LISA ROY, Designated Federal Officer, Deputy Director, Division of Risk Management Supervision
LUKE BROWN, Associate Director, Division of Depositor and Consumer Protection
PATRICIA COLOHAN, Associate Director, Division of Risk Management Supervision
NICK FRAZIER, Senior Financial Economist, Division of Insurance and Research
JACOB GOLDSTON, Senior Financial Economist, Division of Insurance and Research
CHANTAL HERNANDEZ, Counsel, Legal Division
SHERITTA HOLLAND, Senior Examination Specialist, Division of Depositor and Consumer Protection
BENJAMIN KLEIN, Supervisory Counsel, Legal Division

THOMAS LYONS, Associate Director, Division of Risk Management Supervision
JAKE MEYER, Senior Claims Administration Analyst, Division of Resolutions and Receiverships
RYAN McCARTHY, Counsel, Legal Division
SUMAYA MURAYWID, Section Chief, Division of Risk Management Supervision
CHESTER POLSON, Senior Financial Economist, Division of Insurance and Research
BETTY RUDOLPH, National Director, Office of Minority and Community Development Banking
CAMILLE SCHMIDT, Section Chief, Division of Risk Management Supervision
KAYLA SHOEMAKER, Section Chief, Division of Insurance and Research
JAMES WATTS, Counsel, Legal Division
SMITH WILLIAMS, Section Chief, Division of Insurance and Research
MERON WONDWOSEN, Assistant Director, Division of Depositor and Consumer Protection

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

(9:00 a.m.)

CHAIRMAN GRUENBERG: Good morning, everybody. I'd like to welcome you all to this meeting of the FDIC's Advisory Committee on Community Banking. We have found this committee, over time, to have been of extraordinary value to the FDIC. The feedback we get from you all has a genuine impact on our supervision and regulatory program, particularly as it relates to community banks.

You know, the FDIC is the lead federal supervisor for the majority of community banks in the United States. We view community banking really as a core part of the mission of the FDIC to maintain and strengthen the community bank sector of our financial system, which really plays a vital and irreplaceable role in the financial system of the United States.

You know, you may hear more about this. We released a survey of bank lending to small business, and I have to tell you, one, this was a carefully done, methodologically sound survey conducted over a multiyear period, so this was, frankly, a serious piece of research. But I got to tell you, it reads like a promotion for community banking in the United States because it really underscores one central point, which is that small business lending is fundamentally reliant on relationship banking; that for all the emphasis on technology and digitalization, when it comes to small business lending, it's the relationship of the bank with the borrower that is the foundation of that activity, which is so central to the financial system and economy of the United States.

And I actually thought that survey was a valuable contribution, really underscoring the role that community banks play in the United States and the importance of preserving and strengthening our community banking sector. So I thought I would share that with you.

Let me give you a brief overview of our agenda for today, which I think will be an interesting one. We're going to start with an overview of banking conditions in the United States from our Division of Insurance and Research and pose a number of questions to you all to get your feedback on what you're seeing in your local markets.

We're going to follow that with an update from our Minority Depository Institutions Subcommittee, which met yesterday afternoon. We're then going to have a further update from our Division of Insurance and Research talking about the state of the Deposit Insurance Fund and also a request for information that the FDIC Board approved to seek input from the banking industry on deposits and particularly uninsured deposits, which really played such a central role in the three regional bank failures last year.

I have to tell you, the FDIC, historically, has paid a lot of attention to insured deposits. I think we learned last year we better pay some more attention to uninsured deposits and really have a more granular understanding of what makes up uninsured deposits in the United States, and they're not uniform and the risks they pose are not identical. So having a better understanding, potentially including more information on the call report in regard to uninsured deposits, is something we at least want to explore and use that request for information as a starting point.

And then after that discussion, we're going to have a presentation on supervision and policy updates from both our Division of Risk Management Supervision and our Division of Depositor and Consumer Protection, as well as our Legal Division. And we'll seek feedback from you all on that.

So we hope to give you a reasonable workout this morning and this afternoon and take advantage of your participation today. So that's my two cents for this morning before I begin.

But we've been joined by Vice Chairman Hill. Travis, would you want to add anything?

VICE CHAIRMAN HILL: I just want to thank everyone for being here today. Thanks, everyone, for making the trip. Always find this group to be a fruitful exercise, and so I look forward to hearing the perspectives today.

CHAIRMAN GRUENBERG: Great. Thanks. And if I may, let me now turn it over to Lisa Roy who will serve as our moderator for today's meeting.

MS. ROY: Thank you, Chairman Gruenberg. Good morning, everyone. It's nice to see everyone today. Since we may have several members of our FDIC Board in attendance today, I'm going to start with some brief housekeeping remarks. The Government in the Sunshine Act imposes notice and access requirements whenever a quorum of the FDIC's Board of Directors meets to conduct or determine agency business. This meeting is not held for such purposes and does not constitute a meeting under the Act.

The Board members present will only engage in general or preliminary discussions that do not relate to specific proposals for action pending before the FDIC. Any specific issues for official Board resolution will remain open for full consideration by the Board following the conclusion of this meeting. If you have any questions, we're happy to answer them.

Okay. Not hearing any, we'll begin this morning with a discussion of banking conditions, so I'd like to introduce Camille Schmidt. Camille is a section chief in our Division of Risk Management Supervision, and Chester Polson, a senior financial economist in our Division of Insurance and Research.

Camille and Chester will provide an economic overview and touch on industry risks. Throughout the presentation, as the chairman mentioned earlier, we want to hear from the committee members regarding your thoughts on these risks, as well as any others that might be on your radar. So we look forward to hearing from you about what you're seeing in your communities.

And with that, I'll turn it over to Camille.

MS. SCHMIDT: Actually, I'm going to let Chet begin. It is nice to see all of you today.

MR. POLSON: Thank you. And good morning, everyone. I'm starting with just a brief overview of recent economic conditions, and mild forecasts will be much more interesting to hear how they kind of compare to what you're seeing and how they're affecting the conditions that you're operating in.

But with that, I'm going to start with a reminder of recent trends in GDP growth. Economic growth has been strong in recent months. While GDP growth slowed in the second half of

2023 and into the first quarter of 2024, sparking renewed fears of recession being imminent, GDP growth then accelerated in the second quarter of this year. And that's actually the last bar chart you can see here.

GDP growth was 3.0 percent in the second quarter. And I think, more important than that, the expectations for economic growth were consistently revised up over the quarter and then the advanced estimate when it came out in July. I know it can feel like quite some time ago, talking about second quarter growth here in November. It still exceeded expectations.

In the second quarter, there were strong gains in consumer spending, which has remained resilient as a driver of economic growth for several years now despite headwinds from high prices, and also gains in investment and inventories, which is more of a temporary boost you'd expect to kind of go up or down quarter to quarter.

Third quarter GDP growth came out last week, so after this chart was prepared, and it follows a similar pattern to second quarter growth, exceeding blue chip consensus expectations after being consistently revised up over the course of the quarter. The U.S. economy is estimated to have grown at 2.8 percent in third quarter, and those numbers are recent enough that they will be revised up a couple more times before a BEA is done with them but still very strong growth and higher than was expected at the start of third quarter.

For comparison, on this chart, the GDP growth is just under the top 10 percent of expectations, so the dark blue dashed line, that's 2.8 percent, so well above the consensus, the middle light blue line. And, again, consumer spending was the largest contributor to growth, along with government spending, in the third quarter.

Going forward, expectations are for

growth to fall back closer to potential GDP in coming quarters, but, as you can see on the chart, the consensus expectations and even the most pessimistic expectations in the group, those are the gold dotted line, are calling for growth for the next 12 months.

The odds of a recession given by recessional forecasters have fallen in recent months, kind of coinciding with the strong economic growth I've mentioned. The October blue chip consensus, again, the numbers that are reported here on the chart, put the probability of a recession occurring in the next 12 months at 28 percent.

There's still plenty of risks for the outlook. Cooling labor markets may be key among them. Since 2020, we have moved from a period where labor markets were really tight, worker shortages were common across industries, and monthly job gains were historically high numbers. But as supply and demand in the labor market have come back into balance, we've seen job gains slow and job openings and other measures of labor market slack come back to normal levels. The slowing was needed.

And then a greater than expected increase in the unemployment rate in July, which was reported in early August, triggered a lot of discussion. There was some financial market volatility following that and a lot of press in the news about that, specifically because it triggered the Sahm rule, which is one of the recession indicators that's closely watched in the labor market. As a quick summary, the Sahm rule is considered a reliable recession indicator and is activated when the three-month moving average of the unemployment rate rises a half percentage point more than it had been in the past 12 months.

Since then, the unemployment rate has drifted back down to 4.1 percent, but the October payroll gains came in much weaker than expected, just 12,000 jobs. This was depressed due to two hurricanes and a strike disrupting the survey, survey response, and employment growth. The BLS does not actually estimate how much the hurricane itself affected that. They simply said it probably affected it. And one bad data point doesn't make a trend, it takes two. So going forward, you know, employment will be closely watched with the November job gains when they come out in early December.

Another key piece of the quick economic summary is inflation, which has continued to moderate. It remains above the Federal Reserve target. This chart here on slide three shows the headline Consumer Price Index inflation, one of the closely watched ones -- that's the gold line -- which was 2.4 percent from a year ago in September, the most recent data point. Within it, food and energy, which are always volatile, food was up in September more than it had been growing recently while energy fell mostly due to lower gasoline prices. Core inflation, which is the light blue line on the chart, removes those and, as you can see, is higher at 3.3 percent from a year ago in September.

At this point, a big component of the stickiness and high core inflation is housing, which experienced dislocations as the pandemic restrictions ended and continues to face both affordability and supply issues. The consensus expectation is for headline inflation to continue to moderate -- that's the dark blue line in the gray forecast area -- and the consensus expectations for headline inflation to reach the Federal Reserve target by late next year, again shown here in the blue-chip consensus.

And, of course, interest rates are an important part of the current economic and banking conditions. This chart here shows the federal funds rate, which, after increasing so suddenly to fight high inflation in 2021, has kept financial conditions very tight. The Federal Reserve has begun to loosen them, beginning by cutting the federal funds rate by 50 basis points, a larger-than-expected reduction in mid-September. Today, we will get the results of the most recent FOMC meeting and expectations are for further reduction of 25 basis points this afternoon.

And then, at the far end of the chart, I think the most interesting piece of this, the expectations are for the rate reductions to continue, however, at a slower rate than they have been kind of this quarter. The expectations are to reduce further until the federal funds rate makes it down to about 3 percent in the medium to longer term.

Shown here are both the market forecast as of October -- that's the dotted line -- and also the most recent FOMC Summary of Economic Projections. Those are the blue dots. The market forecasts are currently calling for a slower cut than the Federal Reserve. That's because the Fed's blue dots are lower and closer in to where we are now, and that suggests that the markets have a stronger view of economic conditions and less of a need for interest rates to decrease. But everyone is calling for, you know, further slower cuts in the near term. Expectations, of course, lower interest rates will help with deposit costs, but also affect NIM in the medium term.

The yield curve, not on the chart, but is related, was inverted for two years. Another common recessionary signal when the yield curve is inverted with the shorter-term rates being higher than longer-term rates, but it righted itself in early September as the markets came to price in this federal funds rate cut that's already occurred.

The uninverting of the yield curve is also a common recession indicator signal. That's mechanical. As the Federal Reserve starts cutting interest rates, normally that will come off a signal that they're already in a recession, and so they're adjusting things.

But there is still some chance of a soft landing this time, and part of that is both, since the initial cuts in September, both the two- and the ten-year have drifted back up after falling and they're back at highs seen in July of this year, so they've kind of retraced most of that as investors kind of continue to improve expectations for the economy in the long term kind of coming off the expectations for GDP growth that we saw on the first slide.

MS. SCHMIDT: Thank you, Chet. Now we're going to move on to the financial performance of the banking industry and community banks. So if you look at this first chart that I've pulled up, it shows the annualized net interest margin for community banks on that top dark blue line and the industry on the bottom line, and this was over the last two years.

Community bank net interest margins are consistently higher than the industry, and that's because community banks tend to have more loans on their balance sheets. But you can see that the NIMs follows similar trends.

All banks benefitted from rising rates in 2022. Community bank net interest margins peaked at 3.7 percent in the fourth quarter of 2022. Since then, you can see that net interest margins have gradually decreased as funding costs have caught up with asset yields. Not only are banks paying more for deposits, they're also relying on more expensive funding.

Time deposits continue to rise as a portion of deposit funding, and wholesale funding has risen notably over the past two years. And I'll dig into that on the next slide.

As Chet mentioned, the Federal Reserve cut the fed funds rate in September, and we expected them to do so again today. So we'll observe how this will affect community bank net interest margins in the coming quarters. Historically, higher interest rates tend to improve net interest margins and lower rates tend to be more challenging and shrink net interest margins.

So this chart shows the quarterly growth in total deposits for community banks in gold and for the industry in dark blue. Deposit growth has been challenging over the past couple of years. In fact, the industry lost deposits for six consecutive quarters between second quarter of 2022 and third quarter of 2023. That's those dark blue bars.

This has forced banks to compete for a smaller pool of deposits or opt for pricier wholesale funding. You can see that community banks have fared better than the industry and reported slight deposit growth throughout much of the period. Community banks recognize broad-based deposit growth in fourth quarter 2023 and first quarter 2024, but that slowed a bit in second quarter of 2024.

Over the long term, deposit growth is generally slow and steady, but the past few years have been a little bumpy. They've been disrupted by significant economic and monetary policy changes. So the recent rate cuts and the normalization of inflation that we've just talked about may bring deposit growth back to a more steady trend. That's something we'll be watching.

So like I mentioned, on this chart we'll delve more into wholesale funding, and this chart shows the dollar value of the most prevalent wholesale funding measures for community banks on the left axis and then the percentage of all wholesale funding to assets on the right. In order to keep up with loan demand and to make up for that weaker deposit growth in 2022 and 2023, community banks grew their wholesale funding balances, most notably in Federal Home Loan Bank borrowings and brokered deposits.

In 2024, wholesale funding at community banks has leveled off in total and has declined a little bit in some categories. I'd like to note that the largest category of wholesale funding for community banks is public funds from municipalities. I think we've talked about those in past meetings. They're not necessarily as rate sensitive or as volatile, but they do present their own unique risks.

So with that, the best part of the morning is opening it up to hear about what you're seeing on these topics. We'd like to hear a little bit about the economic conditions in your communities and what's going on with interest rates.

Last time we visited in the spring, you all had a pretty heated discussion about the intense competition for deposits, so I'm really interested to see how that has evolved in your communities and maybe your experience with wholesale funding and attracting deposits.

Just for a sense of time, we'll talk about this until break and then, at break, we'll switch and talk about loan growth and credit risk.

So with that, would anybody like to get us started? Thank you, Lillous.

MEMBER SHOEMAKER: In Mississippi, things are pretty stable. We have a good economic outlook. I am starting to notice some of the dollar stores shutting their doors, which reflects some lower-income people, I think, are struggling more. We all know groceries are high now, but, overall, industry seems to be good.

Going to the next question, the deposit challenge remains, Camille. We are starting to let some deposits go. Our competitors are offering higher rates that we cannot sustain, so we're letting some of those walk. Our liquidity position is good, though.

And jumping over to loan demand, we're

very fortunate that, as with our spring meeting, our loan demand is still strong, although I would say it has curtailed with intention. The past three weeks, we've seen a little bit less of a demand. But, overall, I think the Mississippi economy is doing well.

MEMBER RICHARDS: Troy Richards, Guaranty Bank. If I could just piggyback back off of Lillous, we're the two southerners down here on the end.

As far as economic conditions in our communities, it's kind of a mixed bag. We've seen the promise of some new industry coming to the south, data center type businesses. We've got a couple of them in the works right now that looks promising for jobs. And that's on the positive side.

On the negative side is the ag situation that's currently underway. We don't do a lot of ag lending ourselves, but some of our competition does, and it's looking dire. There's likely going to be some Chapter 12s this year that we haven't seen in many, many years. People that were farming before might not be farming going forward, and that's a combination of factors: input costs, prices that they're getting for their crops, it just doesn’t cash flow.

We have a lot of banks that do 90/10 loans, and, you know, they just keep kicking the can down the road. We don't know how many years they can keep doing that before you have to pay the piper, but I think he's wanting to get paid. And so it's not looking real good from that perspective, and everything is affected in our area by agriculture. So if ag does bad, everybody does bad, so we're kind of keeping our ear to the rail with regards to that.

On deposits, like anybody else, you know, loan growth has been good because you can find anybody that will want to make a loan, but deposits are a finite commodity and it's a zero-sum game. If we gain a deposit, that means

Lillous lost one. And so we get into this rate game, and everybody loses except for the consumer. They get higher rates on their deposit. So it's tough, and so banks are having to rely more on some of the wholesale funding, which we don't really consider to be a problem necessarily because it's available.

MEMBER REIGELSBERGER: I am Kim Reigelsberger with Preferred Bank. To echo his, we are in north central Missouri. Agriculture is very prominent in our area. I'm from a rural bank. Actually, my husband and I farm, and we raise cattle, so I live it, as well as part of the bank.

The last couple of years, north central Missouri has been in a drought. That's a challenge in itself. We did have some timely rains this spring, which meant our crops, we’re actually having bumper crops. If you want the best yields you've seen in years, this year is it. But you know what comes with that? Commodity prices have just gone down.

So we've actually talked to some farmers that their situation might be that they may have to go into crop insurance because, yes, they've got the bushels sitting in storage, but they're not work anything or worth little. It may not cover all of their crops.

We haven't actually seen that yet. You know, we still have some crops in the ground, so not everything is out, so there's still more to come on that. But on the cattle industry side, the drought year was last year. When you're raising cattle that you have the brood crop where you've got the mamas, you've got the cows, and you have the bull. When it's hot and dry, nothing happens.

So this year, you know, it takes a while before that baby calf can be born, and so this year we're seeing the results of the drought from last year. The calf crop is way down. I think one of our local vets thought, he thought maybe 60 percent is all we're going to have this year. I can say from my personal experience that's probably pretty accurate, which that doesn't affect too much now but, if you don't have those baby calves coming on and you don't grow them to market because they're not there -- another year, then the consumer is going to see the difference. So that's something else that we're kind of managing.

Right now, most of our farmers have been able to take advantage and have grown equity. I don't think this year, I'm not saying it's not going to hurt them, but it's going to be much easier for them to maybe absorb a year. Now, if it goes on to a second year, that might be a little bit different, so we'll kind of see how that plays out.

We have already seen, as far as the deposits goes, we haven't really played the game of trying to match our competitor. We've got two competitors locally. They need money bad because their CD rates reflect it. We've tried to monitor that. We've got one special that we're trying to, if we think somebody is going out the door, you know, they look at our rate sheet, maybe we can keep them. It's not as high as our competitor, but maybe they don't want to move either, because it's easier if you leave it there. That might be an option for them -- we have seen go out the door. We've decided we're not going to match it, so if we have the option to maybe go to Fed Home Loan Bank, kind of give us a little more liquidity. We're not really needing it for lending. What we're doing, we're just making sure that -- we're very conservative, so making sure that liquidity cushion is there is what we're doing. We're not doing it for lending reasons. It's just to help make sure you can sleep at night and feel comfortable about that.

So that's kind of us in north central Missouri.

MEMBER DeVAUX: So can you all hear me

okay? I don't know if this thing is working or not. Yes, I guess it is.

All right. So I am from the Miami area. Talk about being from the south, well, we're a lot further south than you are, although people would say when you leave Orlando and head south you go back north again. But that's another story.

Florida has been interesting because, throughout the pandemic, we were getting a thousand people a day moving to Florida. We're starting to have problems now because we have insurance prices that are out of this world. And I know that's lending, we said we'd talk about lending later, but a lot of people come to Florida to invest. A lot of foreigners come to Florida to invest, and it's scared them off. Insurance is really scaring people right now.

The other thing is interest rates are very, very high. People don't like to pay the interest rates. Floridians don't want to pay the interest rates, plus they've got the exchange rates problem. So the exchange rate, like the Brazilian Real is 5.5 to a dollar. It's very, very high, so it affects the deposits coming in. There's a lot of competition. A lot of people use Florida as their, because of the retirement people there, they use it as a place to gather deposits.

So we've had to go to Treasury rates on our money markets, which is sometimes very difficult to do. We haven't used a lot of brokered deposits. We don't use a lot of internet -- Internet deposits are even higher, but it has had an impact.

And some of you probably remember the Surfside condo collapse. The regulations passed in order to address that has scared people away from condos because now there is a rule that you have to do, depending on the height of the condo, you have to do the certification. You know how you used to say I'm going to do a loan but I'm not going to do a loan with a maturity longer than the lease is? We're not going to do a loan on a condo with a maturity longer than the re-certification coming up next. It's been a significant drop in the prices of condos, especially in the older buildings. So it is affecting money coming in and deposits coming in, so it's been very, very competitive.

MEMBER MJARTAN: So the first question, you know, we’re fortunate, OPTUS Bank and the other banks that I'm involved with are fortunate to work in states that have tremendous in-migration, so we don't have a lot of the rural, going back to my Mississippi and Arkansas days, we don't have those cycles. So South Carolina, North Carolina, Florida, Georgia continue to just have massive gains of population and economic growth, not evenly spread out across all the markets but most of the markets that we work in. So we've been really benefitting from that economic activity.

The interest rates, as some of my colleagues say, the deposits used to be asleep. They're awake now, and the customers are really awake. And so even when the rates dropped last time, we tried to cut some of our deposit rates, but we really couldn't without running off a bunch of them. So there's a significant lag. Those betas are going to behave very strangely, I think, for a lot of our banks. There's a significant lag in us being able to re-price those deposits because we're experiencing stunning loan demand, and liquidity remains the single, I guess, if I have to say, single greatest risk and predictor of our success, is access to deposits. We have plenty of capital, plenty of great credit quality available to us. We just don't have the liquidity to fund it.

We could grow exponentially every quarter just about. The loan demand is there, and the consumers continue to perform exceptionally well. We again had several quarters of -- we'll talk about loan quality, so I don't want to jump into that, but deposits are related to that because we're pricing the deposits to meet the needs of our communities, to generate the liquidity. Thankfully, we don't have to rely on any wholesale funding, but it's good to know that it's there. So we do have some strong feelings about the brokered deposit rules and things like that that could impact us negatively in the future, but generally speaking, we're not relying on any of that simply as a contingency funding plan has those sources in it. So it's good to know that it's there.

That's it.

MEMBER DRENTLAW: Hi. Anita Drentlaw, New Market Bank, southwest metro of the Minneapolis-Saint Paul metro area. I'm going to say that economic conditions are actually very similar to kind of what you guys presented in our area. I mean, we seem to be doing, I would say, okay. Business seems to be kind of as usual, I guess.

There's definitely been an increased feeling of uncertainty lately, however. As maybe irrational as it sounds, I think the election had a lot to do with that and I kind of expect now that that's over and things are decided, that business outlook may be a little bit different or at least settled so that people can make decisions, or they think that they can now. There was just, I felt, a lot of uncertainty in our area just not knowing which way the election was going to go.

I'm going to agree that falling interest rates have not really affected our ability to re-price anything. We lagged on the way up, and we're definitely going to lag on the way down. We haven't re-priced anything, and, I mean, we need to be able to keep and retain those deposits. We have seen a decrease in our overall deposit base, but a lot of that, I believe, is due to people just having less money because prices have been so high, insurance has increased a lot, food has increased a lot, just living expenses in general. And so I think a lot of our deposit loss has not necessarily come from leaving to go to other institutions. It's been more of just a decrease in -- people having less money in their pockets.

And we don't rely a lot on wholesale funding either. We had had some brokered CDs, and we took part of the Bank Term Funding Program when it was available. It was more because, at the time, there was uncertainty, you know, with the bank failures and stuff, the large bank failures. We took out some wholesale funding, thinking we weren't really sure what was going to happen. And then the last Bank Term Funding Program advance we took was because we could make money on it from the fed funds being over what we were being charged. That program, it was beneficial for us for the first nine months of the year, and then we paid it off as soon as rates decreased in September.

So right now, we have no wholesale funding on our books, but, at the same time, you know, keeping those avenues open is extremely important for us, you know, for liquidity purposes.

MEMBER HORTON: Good morning. I'm Sue Horton, and Wheatland Bank is based in Eastern Washington state. And when I think about our economic conditions, like you, we have a lot of in-migration into Eastern Washington, Idaho, Montana. We call it the Yellowstone effect with the show.

But when I think about economic conditions, I would say they're strong generally speaking, except for the agriculture markets, like others have already expressed. Washington state is actually number one, two, or three in at least 30 of the top crops in the nation, and that's driven by the great Cooley Dam irrigation project, and so we have a lot of irrigated crops and we're very diversified in the state.

So ag is very weak right now. The apple market is a disaster. Hay is very weak. Many of the crops are, and exports are down. I think cattle in our area is maybe the one exception, but we've always worked with our ag customers. We've had zero loan losses in the past decade, and a lot of that is because of their strong real estate equities that we're able to work with borrowers during the cycles of ag and have a history of doing that.

So on the commercial side, loan demand is very strong. We see a lot of multi-family housing, a lot of hospitality. We're at concentration limits in several areas. We'll get into lending later.

On the deposit side, we generally have run close to 45 percent noninterest-bearing deposits, which has been wonderful for our cost of funds and our margins.

With this latest trend, since Silicon

Valley failure, we saw just tremendous competition in the rising rate environment by brokers, as we all did, and a lot of outflow of deposits. I think that's definitely stopped. You know, we never lost a lot of it. We did compete as best we could, but we were slow, lagging on the way up, and I think we all kind of learned from that, and we'll be as slow as we can on the way down.

So we also have learned, you know, it's great to have large noninterest bearing deposits. I think, for us, treasury management really helped secure those relationships in a sticky way, as does our consumer free checking with a free gift product. It's kind of been our secret sauce, and we find that, having those more granular level of deposits in core deposits, you don't have as much risk when you have a lot of pricing competition, which we do also from credit unions.

One of the things we're noticing in

Washington state, we have five banks right now that are selling to credit unions. I think that's the highest of any state in the country. We are concerned about that. We're concerned about the impact on the federal and state tax coffers, and we just hope that one of these days Congress and Senate will listen on that topic because, like BECU, I think, last year, Boeing Employees' Credit Union, they're the largest institution in Washington state, I believe they made at least $600 million in profit tax-free. We compete with them on everything.

But deposits, we think we're retaining them fine. We don't really rely on wholesale funding, so those are my comments. Thank you.

MEMBER PLUMSTEAD: Norm Plumstead from Honor Bank in northwest lower Michigan. And our economy is very tourism based, and so one of the things that we've observed this past summer is that stays have been shorter, and people have taken longer to book. And so while it hasn't impacted our hospitality business writ large, they're still doing well, I think that that gives a little bit of visibility into what might be coming down the pike.

And we've observed also that kind of K-shaped recovery effect where the higher-income households continue to perform very well, come to town, move to the area, and spend money. But a lot of consumers, as mentioned earlier, are continuing to live paycheck to paycheck.

On the deposit side, we compete with a couple of regional banks, and what we noticed is that, in our market, they were very quick to lower rates in conjunction with the rate cut. And so we were actually able to follow our betas on the downside, and it hasn't had a negative effect on deposit growth for us.

MEMBER BATES: Thomas Bates, Legends Bank in Clarksville, Tennessee. Our market has remained fairly strong. We sort of bask in the afterglow of being 40 miles northwest of the

Nashville SMSA. We have five branches in that SMSA, and that market continues to be very strong.

We're a military town, so there's a lot of government inflows and outflows that kind of help boost our economy during slow times. It sort of puts a cap and a collar on our overall economy.

But we have pulled back on our lending most of this year mainly because there's just a tremendous amount of construction, large construction projects, and many banks in our market have completely shut that down. So they all started coming to us, so we had to be careful on what we took, so we've kind of worked through that and we're getting to the point where we can start turning the taps on again and hope to do, you know, more robust lending over the next six to nine months as the competition is sort of tamped down.

The deposit competition was very tough

the first half of the year, but that has sort of eased with a couple of aggressive banks really shutting their loans down on the CRE side, so the demand has not been as tough as it was earlier in the year, which has been good for us. So it's allowed us to see our net interest margin go up, you know, significantly from a year ago, and that's been very helpful.

But liquidity has not been a problem. We do use brokered and alternative funds, you know, in a modest amount. We do some for hedging on costs and things of that nature, so we find that to be very helpful. But, overall, we've been surprised at how well our economy has held up.

MEMBER HUANG: I'll just echo what a lot of people were saying. We're seeing that a lot of our consumer accounts, it's not that they're transferring money to other institutions or to other type of accounts, they're just spending it. You know, groceries are more expensive. We're seeing that they're using their debit cards for things that they need on a day-to-day basis, so those accounts are dropping.

And so, in order to get more deposits, you know what's available are the more expensive CD accounts or brokered deposits, wholesale alternatives, and we don't rely on wholesale funding but they're definitely something that we keep as options, whether it's the Fed, Federal Home Loan Bank, you know, brokereds, that's all something we use to arbitrage a strategy.

And so, in New York, unfortunately, what's good and bad is, you know, I can throw a rock and I'd probably hit a banker. So we have to stay pretty on par with everybody else, but some banks are a little quicker to react than others. But we have seen rates, you know, dropping a little bit. On the loan side, they've been dropping quicker than on the deposit side, but we'll see how it goes.

MEMBER BARKHEIMER: Marlene

Barkheimer from Farmers State Bank in West Salem, Ohio. Overall, our economic condition is pretty close to national with the caveat that I heard before. I do think -- we did hear of some small businesses that were holding off on growth projects because of the uncertainty with the election, so we'll see whether or not those now come to fruition or not based on that.

We actually had some small businesses that have gotten sold over the last year, so unexpected increase in liquidity because we had loan payoffs. So we had quite a few that had done that, and our loan demand actually had been slow the first half of the year, so that has helped increase our liquidity and we are now in the position that we're going to be paying off some of those temporary funds that we had taken on earlier and get those back off the books.

Overall, deposit competition, I think, with us, we've always been a defensive player in the market. We tried to hold as many deposits as we could, to raise rates as little as we could, and we did just talk about this at our board strategic planning meeting. We do have, being in a smaller area, a lot of loyal customers, so they are willing to take a little less than what the competition is getting. So they'll bring us in the rates that they're seeing. We'll undercut it by 25 to 50 basis points, and they're usually willing to stay. So we're able to kind of keep our cost of funds down in that manner, so that's helpful for us.

Overall, we are concerned about increased pricing, and I know we're going to talk about that, but we're just starting to go through the escrow analysis for our consumers and we're worried about the increase in insurance rates having some effect.

Oh, and a quick thing on the ag side, we are concerned about the effect there, too. Only about 20 percent of our lending is in agriculture, but what we're seeing in our area is the pricing. We're knowing people aren't going to clear lines this year, but they had good years last year, so we think most of them will survive. But we know it's going to be a little bit tough this year.

MEMBER PERRY: April Perry with Kentucky Farmers Bank in northeast Kentucky, and Kentucky is kind of a mixed bag. The central part of our state and the north central part of our state is doing very well. The western part has some areas that are doing really well. The eastern part of the state tends to struggle, but we're very hopeful and we are working hard to bring in more businesses and create some economic growth in our area.

Our bank has always been very well capitalized, had a lot of liquidity. And when rates started going up, I think that the consumers became very aware of how much they could be earning, not just in their banks but with, you know, Treasury products, just exploring all the different options that they had for increasing the return on their deposit. Interestingly enough, they didn't think that that applied to loans. They felt like their loans should stay low, so that's been kind of interesting.

But our biggest competition seems to be the credit unions, and they're going after all the funds. We were in a meeting just last week, and we were talking about how the municipalities need to understand that they're not getting the tax dollars from the credit unions. And so when they're thinking about, if they would move their money to a credit union, what are they going to lose? And so we were talking about how we need to make them aware of how much money they're getting from our bank where we're, you know, we are paying our taxes.

But, yes, the credit unions, there's some fierce competition. And, quite frankly, I don't understand how they're making so much money not paying taxes and naming large stadiums and arenas and, you know, what good does that do for the local economies or for the working poor who they're supposed to be serving. So that's kind of one of my biggest concerns.

I think, though, that the relationships that we have with our people helps us keep those deposits because they know that they can depend on us. So that's the value, like you mentioned earlier, the value of the relationship. We see that in our deposit relationships and in our loan relationships.

MEMBER MAUST: Trey Maust, Lewis & Clark Bank out of Oregon. To provide a slight counterpoint on the economic front, for the past 30 years, Oregon, particularly in the metropolitan areas, Portland obviously being a leading one, had experienced tremendous inbound migration. So hearing that, you know, from Florida, South Carolina, and some of the other states, that was something that we experienced for a full three decades and that really drove tremendous increase in economic activity and housing and the broader economic landscape. And then, of course, certain sectors did very well in that area, so high-tech manufacturing and some of the others.

That's changed since the pandemic in particular. We've seen a tremendous slow-down in inbound migration to almost a complete halt, which has had a significant impact on the economic outlook for the state. In addition to that, the high-tech manufacturing sector, Intel being really the marquee company that's in the area slowing manufacturing. We're seeing about a 4 percent expected decline year over year for the next X number of years, so it does have an impact.

That means, overall, for the state of Oregon, a forecast growth rate of around 1 percent at best, so lagging, overall, the economy, which will obviously trickle down to not just the sectors but to personal income. Interesting, though, personal income is expected to grow by 4 percent per year, so I haven't dug into the numbers to understand how that's going to work, but my question that's still outstanding related to that is how does that translate to the experience that those who are receiving the personal income increases, experience with respect to their individual life because we do see struggles with being able to afford basic goods and services.

So is it broadly across the economic spectrum in terms of socioeconomic, or is that 4 percent really with, you know, certain demographics that maybe are enjoying that and others are not. I haven't dug into that, but we're definitely seeing the impact of that in our state.

In reference to interest rates affecting deposit competition, I would echo a lot of the comments that have been made thus far.

I'd also add to the equation a dynamic that we've seen in perceived safety of funds. So when we look at not-for-profits that might have deposits exceeding the insured limits of, let's say, $250,000 at this point or commercial enterprises that are also looking at putting funds that exceed that amount.

We obviously have vehicles to expand that, whether it's reciprocal or other types of vehicles. But it's very difficult for a treasurer or somebody who is responsible for those funds as a fiduciary to say to their board, well, we're participating in a program that makes sure that our funds are fully insured, and it's just easier to make sure that those are held somewhere where they can point to and say, well, this G-SIB is too big really to experience that, particularly post-SVB.

So that's something I know, and I appreciate that the FDIC has looked at various approaches to expanding deposit insurance, and I don't want to see that get lost in the shuffle. And I know that's a statutory action that has to be taken, but I'd like it to continue as part of the conversation.

As far as a reliance on wholesale funding, I do appreciate that we have an RFP around brokered deposits. I think that opens maybe the door to an expanded conversation around the liability side of the balance sheet, so how can we holistically manage the balance sheet on the funding side as a bank, particularly as we're looking at serving the community when it comes to small businesses and really continuing to be that bastion of capital for small businesses, for innovation within our economy, and really funding the expansion of the economy at the ground level. Oftentimes, that requires core deposits and some end fill, depending on how things are going, provided we don't go back to the pre-financial crisis, you know, overheated loan growth but just, you know, to really take a good look at the overall balance sheet on the liability side would be fantastic.

MEMBER CAMPBELL: So I’m Troy Campbell with Altoona First Savings Bank in Altoona, Pennsylvania. We're a $300 million mutual savings bank, and it's interesting, I think a lot of our lenders think that lending has slowed down significantly, and it has. But our more mature lenders say, well, this is what the norm used to be, so a lot of our lenders were used to just, you know, a low-rate environment, the number of loans we were generating.

Warren and April had hit on the fact that we have a much more aware and informed and savvy consumer, especially on the retail side of things. And so they've become very, very rate sensitive, you know. We're in a rather small community, about -- a town of 60,000 people. The closest big city is Pittsburgh, an hour and a half from us, and loyalty was always a big thing. But I think just with a more informed consumer, that has decreased.

But as Chairman Gruenberg had said, relationships still drive small business relationships. So that's where we've seen our growth and definitely within the past -- throughout, we had steady small business lending, but we've definitely seen that pick up. We deal primarily with entrepreneurs and very closely held family businesses, so they understand that they may be coming into a high-rate environment to do their project, but rates will go down and they'll re-price at that point.

As far as my concern heading into this next season, I think net interest margin is going to be very difficult to manage simply because we have a more savvy consumer and a more interest rate-sensitive consumer. They've gone through a very low-rate environment, and they don't really want to go back there, and they've enjoyed 5 percent on a CD.

We took a very hard approach to try to

restructure the liability side of our balance sheet to move away from time deposits, and we did that successfully. And then Edward Jones woke up and started offering rates that were ridiculous, and we kind of held off on chasing those but then we had to re-price to keep some deposits.

We did use Federal Home Loan Bank borrowings, which was the first time that our bank had ever done that. The presidents before me at the bank had kind of looked at not borrowing money as a badge of honor. I knew there were a lot of banks around us that had very smart individuals that borrowed money, so I wanted to learn how to use that as a tool. And I'm thankful we did that because the Federal Home Loan Bank program allowed us to borrow, you know, at a term that was beneficial for us, allowed us to continue to meet our community needs, and allowed me to sleep at night, as was mentioned.

I'm very interested in what's going on with FHFA, and I hope there won't be significant changes to the Federal Home Loan Bank system because they're a really key tool to community banks and also to communities.

MEMBER CULHANE: Michael Culhane from the North Cambridge Co-Operative Bank. I think I can echo what my colleagues have said, but my bank has experienced problems primarily with the cost of living. We aggressively defend our deposit products. We do some matching when we need to to keep the long-term customers with the bank, yet we've seen some runoff in deposits and it's mostly, I did an analysis, it's not the CDs that's running off, it's basic regular savings accounts. It's an affordability issue with our customers that we're losing deposits.

On the loan side, we do a lot of one-to-four family lending, and a condo in Cambridge, Mass, is north of a million dollars. So the loan payment is pretty large, so our loan demand has shrunken quite a bit because people aren't willing to take that kind of risk. There's really not a lot we can do about that, so we're hoping the inflation will subside a little bit and people will be more able to take some risk.

MS. SCHMIDT: I think everyone has had an opportunity to talk. I do have a question for --

MEMBER CROCKETT: Last but not least. So I'm Carolyn Crockett with First Security Bank of Nevada in Las Vegas. As far as economic conditions, you know, Las Vegas is holding its own. Everything costs too much. Groceries. We lead the nation -- our country second-highest in groceries per week; $297 per week is the average cost of groceries. There's a lack of affordable housing.

But in spite of that, people come to Las Vegas, you know. They're spending their money. People find money to spend.

As far as the deposits go, you know, I've been at this bank for almost nine years, and deposits have never been an issue. We've always had too many deposits, you know, and couldn't get them to work for us. And somebody said that the depositors have woken up. They woke up at our bank, as well, and everything is rate sensitive. We lost probably about a third of our deposits overall after the Silicon Valley Bank, not so much for the flight to safety, but it's all about the rate. And we tout ourselves as a relationship bank. We are a relationship bank. But when it comes down to 2 or 3 percent more on your money, people are going to leave. They like you, but they're going to leave for the higher price on their deposits.

So we have for the first time in almost nine years leaned on some brokered deposits to fund our growth. We don't have any borrowings outstanding, but we have leaned on brokered deposits. And loan demand is there in Las Vegas. There's a lot of opportunity to make loans, but we're going to need to continue to lean on our contingency funding sources in order to meet the loan demand.

So that's kind of where we are in Las Vegas.

MS. SCHMIDT: Thank you. I'm going to pick up on your comment there that customers have woken up, and, Troy, you talked about the interest rate-savvy customer. But are they also more technologically savvy? I'm just interested, have any of you had to change your strategies a little bit on technology, made adjustments to what you're doing?

MEMBER CAMPBELL: In our community, we have not.

MEMBER SHOEMAKER: We haven't for technology, but in, you know, decades ago, a customer banked at that branch. Now they drive to another branch thinking that the rate is going to be different. And, you know, we're one bank, we have one rate sheet, so they're definitely exploring more opportunities and doing their research, and the Edward Jones is always going to be that external competition.

MEMBER REIGELSBERGER: I kind of think you are correct that technology has played a part. The largest town around me is 1,500 people, others are at like 700, 750, so we're a very small area. Newspapers are almost non-existent. It's like four pages. That's where everybody used to do their advertising. Well, they're not advertising on the newspaper anymore. You talked about what the major national investment firms, it's all online now. They go find it. They looked at our competitors, see what the rates are.

So we intentionally reviewed our digital banking products, mostly mobile. Our mobile banking -- now, we have some real good, we hope we have some good stringent controls in place, but that's really taken off. I mean, for us, you know, we run about anywhere from 20 deposits a day, which we think that's great, so you take that times how much a month. So it seems to me like they're using even our website to get pricing on it, so you know they're going to all of our competition because we don't have a newspaper anymore. How else are they going to get that information unless they're going out there, and that's what they do. They check rates online.

MEMBER RICHARDS: Technology for us has been kind of a double-edged sword. Customers are more savvy when it comes to technology, which is not always a good thing because there's Cash App fraud out there and Zelle fraud, which has caused us -- we've turned those things off, which we've had to answer questions from customers, why are you doing that, and we explain we're trying to protect your funds. We, just this week, had customers lose money because they received phone calls from people purporting to be from the bank. They gave out their internet banking log-in credentials to the fraudster. The fraudsters log on, set up external transfers through our online banking platform.

And so technology has not always been a good thing. That's why we're seeing -- the more this happens, the more safeguards kind of get put in place. That's why they're reverting back to check fraud, and, you know, the big banks are not sufficiently managing their technology because they're allowing anything and everything to be remote deposited into their institution, which is causing us tremendous amounts of check fraud losses for community banking.

But, you know, you look at technology like FedNow. We are not doing FedNow, and we always get asked, well, why don't you all want to do FedNow? It's because they haven't figured out the liability issue on the fraud. Faster payments equals faster fraud as far as I'm concerned, and, until those questions get answered as to who is going to be responsible, we're not biting, and we don't really have a demand for it anyway.

So technology is out there. The more AI comes into play, the more the banking industry is going to have to take advantage of AI -- use good AI to combat the bad AI, and it's going to be a real challenge going forward.

MEMBER DeVAUX: Before the pandemic, we had people we said would never, ever use the electronic access to the bank. That changed. The pandemic changed that big time, and so we've had a big focus on the technology.

One of the things is account opening online, and we've seen an increase in that, which expands our market. We only have three locations. We're about $550 million, so that has been an advantage to us. The fraud is up. A lot of the fraud is just the basic check fraud, so that's not a technology issue, but we're starting to put more tools in place now, you know, the KYC, Global KYC, things like that you can automate to figure out where the customer is coming from and whether they have a background and things like that.

So we're trying our best to take advantage of the technology, and we do Zelle. We definitely do Zelle. We do FedNow receive only. We do not do send. We are very concerned about what happens with wire transfer fees because we get a lot of wire transfers, especially we have a lot of international customers. And I don't see the business case for FedNow yet. I do see a huge problem with wire income, fees on wires. So we'll have to figure out what the business case is going to be for that, but, so far, the technology has been an advantage for us and we're going to continue to push it pretty hard.

MEMBER BARKHEIMER: The one thing that we're seeing with the technology is the fraud, increase in fraud. And a lot for us, because we're a small community bank, is on seniors. We see a lot of people that get caught up in the we talked to somebody on the internet and they're sending me this money. You know, again, we're small enough that we can kind of recognize that people are getting unusual transactions, and so we've had to explain to customers that, if you don't know this person, don't accept the money or we're going to send that money back, we're not going to take it. And we've closed accounts because of it, which we get very upset customers, but we can't keep babysitting the same customers that keep doing the same thing all the time. And it's just too much work on our part to keep doing that.

So it's unfortunate and I hate to do that. When I've got somebody that's living on Social Security because I said, you know, I'll give you three months to close your account, but this is the third time we've caught you taking illegal wire transfers because we know you don't know the people where it came from and we can't keep monitoring your account that closely. You know, find another bank that's willing to do it for you.

That's really hard for us, but we don't know how to get people to understand that nobody is giving you free money. That just doesn't happen.

MEMBER DRENTLAW: And we're seeing the same thing, except for us not just with seniors. We've had several 20-year-olds that have been falling for the same type of scams, and so it's across our entire customer base. We've actually seen almost a little bit less in the senior citizens and more in some of the younger adults who I think during the pandemic really struggled with not having any social interaction and now are finding people online that they think that they should trust.

But I'd echo all the fraud. It's rampant.

MEMBER CAMPBELL: I actually had a daughter-in-law who received a call from our county sheriff's department, and they used fear to manipulate her. And she walked out of the house and ended up doing numerous withdrawals, which triggered our branches to call me and say is something going on with your son and daughter-in-law? And shortly after, my daughter-in-law called and said I made a mistake. I mean, they ended up having her withdraw $58,000 and kept her on the phone, would not let her leave the phone, directed her to a Bitcoin machine. I mean, once the money goes in there, it's just gone. It's not traceable.

And so, I mean, customer education has become so crucial for us and making sure we're communicating with our customers on just the dangers. And it's not a difficult thing to combat once they have the knowledge, but it's getting people to understand, like, no, this is not your boyfriend or girlfriend that's going to marry you that's asking you for this money. It's really hard. I mean, we try to educate, but it's really hard when people think, wait, I'm going to get $30,000 out of this or contrarily, the other side of it was my daughter-in-law thinking, like, I mean, she's probably never done anything illegal in her life, but they convinced her that she was going to be arrested if she did not pay these fines for something that she didn't even have any type of -- you know, it's just the motivation of fear is amazing.

MEMBER PERRY: It is really scary. What's the scariest, I think, is that the lower the financial literacy, the more likely they are to fall for these scams.

And so it's so important that we educate our customers and the consumers on fraud and also educate our bankers, so the Kentucky Bankers Association has started a fraud academy. It was actually started through Central Bank in Kentucky. But the Kentucky Bankers Association has taken this on, and it's a fantastic program where they're training bankers on how to spot fraud and how to stop it.

I'm also part of the Kentucky

Financial Empowerment Commission, and that group is just tasked with increasing the financial literacy in Kentucky because there's so many people that just, they don't know how to manage their money, let alone spot fraud. And I guess the people that can least afford it are the ones who are going to be taken advantage of.

All that comes back to the relationships, right, you know, that we have to be watching out for our customers, and we have to educate our bankers on how to stop this fraud.

MEMBER REIGELSBERGER: Sometimes, that education piece is very, very hard because they don't believe you because they've been talking to them for maybe months that we're not aware of. And you feel like you're hitting your head against the wall, and I don't care if you close their accounts. That's been the most frustrating part. We can give them information face to face. What we're seeing is not just maybe that caliber of financial knowledge, it's all across the board. They think that they're smarter, that they won’t get caught up in it, but they do. And I don't know what to do. I feel like education is not working. I don't know what else to do about it, though. Continue to watch as best we can and help them out.

MEMBER PLUMSTEAD: Obviously, we're facing those same challenges but just a different perspective on technology, which is our challenge is knowing where and how much to invest in technology. So we've had instances where we've partnered with fintechs and the promise is, it's going to save you one or two FTE, and the reverse is true. You have to hire a subject matter expert.

And so just being able to keep up from a technology standpoint to be able to offer our consumers and business customers what they're looking for from the larger banks has been the challenge. Of course, don't get any of us started on the core provider challenges, but we really are beholden to, our mobile banking app is whatever, Jack Henry in our case, is offering at the time. So that's what we're feeling.

MEMBER HORTON: I'll just add we're on Jack Henry, as well, and we've cut the time to open a new account in the third. So with technology, I think it's improved our efficiencies. We're doing more faster with fewer personnel on account openings as an example.

And we've also experienced everything others have spoken to with fraud and trying to educate. And we've even had employees get caught up on it where on social media they've been groomed for about eight months to thinking this is a friend and then they learn where do you work, where do your kids go to school, what church you go to, and then they're extorted for financial sums.

And, fortunately, the employees did the right thing, came forward, told us about it. We could block some of the IP addresses, but some younger people and like your daughter-in-law with fear, you know, they don't come forward. So I think it was surprising to have that happen to one of our best commercial lenders. I got a phone call on a Sunday night, and she was crying telling me they were trying to get $80,000 out of her by Monday morning at 10 a.m. And it went on for months. Even though her church, the children's school, and the bank tried to block everything, this individual wouldn't give up for months. And the thing is AI. They take their face and they add naked photographs and they threaten to put those out there.

MEMBER DRENTLAW: I want to add on one thing to what you said, too. I think there's a perception that community banks don't have the technology that some of the larger banks do. This was really apparent to me at a recent strategic planning meeting with one of our board members who has a fairly large business, and she's like, well, I can't really bank with you because I've got people who live in, like, a different state and stuff, and I'm like, well, that's not the case. I mean, she's intelligent, but her people are like, well, you can't do payroll with them. And it's like, well, yes, you can.

So I think there's a perception out there that just because you're smaller doesn't mean that you have the resources to be able to actually provide the service to customers. So trying to change and educate that, no, we actually have all those services, and we can actually provide you with a deposit account that functions across state lines is something that's challenging for us, too.

MS. SCHMIDT: All right. Well, great perspectives. Lisa will give us the logistics on the break, and then we'll come back for, I'm sure, a robust conversation on credit risk and loan growth.

MS. ROY: All right. Thanks for that great discussion. We're going to go ahead and take 15 minutes for a break, and we'll see you back in a few minutes.

(Whereupon the above-entitled matter went off the record at 10:15 a.m. and resumed at 10:41 a.m.)

MS. ROY: All right. We're going to pick up where we left off. I'm going to turn to Camille and Chet to get us going.

MS. SCHMIDT: All right. Thanks, everybody. Nice break. So like I said, we're going to turn to discussion of loan growth and credit risk, and I just have a couple of slides to get us started so just overall on the industry.

Just as community banks recognized higher deposit growth than the industry, they've also experienced higher loan growth than the industry, and that's across all loan types and you can see that on this chart. Total community bank loans grew 6.3 percent over the past year. The loan categories with the most growth were home equity lines of credit, that's small portfolio, but those grew by 12.7 percent; ag loans were up 7.2 percent; and permanent residential at 7 percent.

Higher loan growth over the past few years has helped support those higher community bank net interest margins. But as we've discussed, it's also posed liquidity challenges as banks have used cash balances and took on expensive wholesale funds to match loan demand, and that's what we're seeing, you know, at a macro level.

Then I'll close out with this chart on kind of credit quality with a look at loan delinquencies. On this chart, you can see that the overall past-due and non-accrual rate for CRE, construction, consumer, and commercial and industrial loan portfolios.

High inflation and increased borrowing costs in 2022 and 2023 drove consumer delinquencies above pre-pandemic levels. You can see that in the top line, the top gold line, while other lending categories have experienced a more steadily rising delinquency rate.

Those delinquencies remain at manageable levels, overall, consumer loan delinquency rose 56 basis points over the past year and C&I delinquencies rose 36 basis points. Construction delinquencies rose 54 basis points, but that was from a much lower level. So total CRE delinquencies, which we talk about a lot, those remain the lowest of the categories shown, but they did rise 33 basis points over the past year. FDIC quarterly banking profiles have noted that CRE delinquencies are concentrated in the largest institutions rather than the community banks.

So I think you can all speak to some of those points. And with that, we'll get started. Would anyone like to tell us your experience with loan growth or credit quality.

MEMBER REIGELSBERGER: I'll start, I guess. As I mentioned earlier this morning is about agriculture. As we've seen rates adjust upwards, we kind of look at those at a case-by-case basis and see if any additional, if we need to kind of renegotiate the pricing as far as the interest rate. However, up until more recently, our ag lines have been really good. When I say commercial, commercial to us is maybe a mom-and-pop business, so we're not talking big corporate-type commercial loans. You know, we have a diesel mechanic with two employees. To me, that's a commercial loan.

So we've had to kind of watch as things have re-priced to see how that fits with that borrower. I think, as far as our ag lines, it's going to be interesting to see when everything is said and done how many of them are going to be able to pay off their operating lines. They kind of have built up equity in their real estate, so, if there happens to be one or two, we might be able to work with them on that and tie it back to real estate. So we've been really watching that.

Land prices in farming, they've been pretty stable. I think the current economy, and farming especially where commodity prices have lowered, I think that is the reason why our land prices, the very most fertile ground which is by the Missouri River or Mississippi River is running 12, 15, 16 thousand dollars an acre. If you're looking at just some gently rolling, probably 6 or 7 thousand dollars an acre. If you're talking about pasture, probably 4 or 5 thousand dollars an acre, which is still unheard of, I mean you can’t find pay for itself.

Anyway, as far as our ag portfolio, I feel like, at this point in time, I don't really see major problems. I think time will tell on that.

So back to our commercial, everything we do is pretty much 99-percent owner-occupied. So we're loaning to the borrower that owns that business or owns that piece of real estate, that runs their business out of it. I don't have anything.

Every now and then we get a hiccup with a one- to four-family. We do a lot of small loans. It's not unusual for us to make a $50,000 house loan. They live in a $65,000 house, so it's just the nature of the area we're in that it's very comparable. So if those people have a hiccup with their income stream, we may have to work with them a little more. So it seems like it doesn't matter what the appraised value of the home is. Kind of the situations are kind of similar across.

Even though we've come out of the official drought designation, we are now still in a dry. If you've ever been in farming and you see how dusty combining through beans or corn is, that dust is combustible, so the thing that the farmers have to watch out is will those combines catch on fire. You can't believe how much they cost. You're talking a half a million dollars, depending on bells and whistles, up to a million dollars. I'm sure there's insurance, but you still don't want that to happen.

But, anyway, those are some of the things that I'm seeing in my area in Missouri.

MEMBER CAMPBELL: So our loan demand was steady and is definitely increasing on the commercial side. Again, small business closely held.

Credit issues, we definitely have seen an increase in delinquency. However, I mean, when your delinquency was at 0.01, we're still below 1 percent. And by delinquency, I'm talking over 30 days. We've had some that have gotten over 90 days. We're looking at our first foreclosures in a few years. But we've definitely seen a slowdown in payments on some customers that, historically, have not had slow payment histories.

As far as stretching customers on the adjustment in rates, so we were making loans, say a business -- we lend off prime, so prime plus 75 or 100 basis points, that was fine when prime was low. But whenever it shot up to 8 - 8.5, we would work with the customers at that point, understanding -- and we were able to do that just because we were still able to manage our NIM well at a lower rate than having to be 100 basis points over that.

We don't do a lot of CRE lending. I mean, I sit on committees with people from New York City and Philadelphia, and I hear them talking about the office space. I can't imagine what that would be like, but we really don't have concerns about that because that's not the type of community that we exist in. But we definitely are seeing a slowdown in payments and also an increase in utilization of lines. We watch that very closely.

MEMBER RICHARDS: On our loan demand, when rates were heading upwards, we thought we'd see some slowdown, and we did initially. I think once the shock wore off, the desire for the deal outweighed the fear of interest rates.

And we do a lot of commercial real estate lending, not in office space but in one- to four-family. We finance a lot of property owners and landlords. And we're a CDFI bank, and so we even had a loan program to have borrowers purchase and rehabilitate depressed housing to make more affordable housing available in our area. So that worked out real well.

But we're starting to see some credit quality in that line of lending, and I think it's just a lag because what we've seen is, you know, during the pandemic, people were told you don't have to pay your rent, and they sort of got in that mind set. And you couple that with inflation now, consumers, they're going to pay their phone bill and they're going to pay to drive their car and other things. The rent is going to be way down on the list.

And so they're not paying our

borrowers the rent payments like they should, and then our borrowers are going to have to go through that legal process of trying to get them removed from the property, which is a chore in and of itself. And in the interim, the property is not being taken care of in a satisfactory manner. They finally get the person out. They go in, and they've got to replace the water heater and the kitchen sink and other things. And they didn't have enough liquidity to withstand the rainy days that were coming.

So, in some cases, we're having to loan them more money to fix up the property in order to rent it out in order they can get income in to make their loan payment. So we're starting to see a little bit of that trickle in, but we're managing it borrower by borrower.

As far as other lines of lending, we do a lot of C-store lending, which C-stores do very well. The only concern we've got there is any sort of potential impact that the climate change religion would have on C-store lending and how that's going to affect our customers that borrowed money for that. So that segment is a very strong segment for us, and it's still very strong.

Credit cards, we issue our own credit cards. We carry the credits on our books. We've seen a slight uptick, you know, in past dues, but nothing really major. We don't really give credit cards to people that need one, so it's worked out pretty well for us. But I know the national trend is uptick in credit card because, again, I hate to blame everything on the pandemic, but people got in a standard of living because of the free money that was being doled out. And when the free money got cut off, people chose not to want to lower their standard of living back to the way it was. And so they're financing their new way of life on credit cards and not being able to pay those back. So we've seen a little bit of that, but not much.

MEMBER SHOEMAKER: We're also a CDFI bank, and we have a good mix of commercial and consumer portfolio. We typically run 80 to 90 percent loan-to-deposit. We've seen, consistent with this report, 5 to 6 percent loan growth. It has definitely softened over the past three weeks.

At our spring meeting, I noted that we had a little bit of credit issue in the C&I specialty equipment. We've resolved that. The only issue, I think, it's interesting you said that, Troy, is we are mimicking the national trend on credit card debt. It's still very minimal. We issue our own credit cards, same thing, but we're monitoring it closely and we're stress-testing intensely our entire portfolio. And I think that probably, credit card and regular loans, I think that's how we've been able to monitor it so closely.

And the re-pricing on loans, interesting, we've gotten some fantastic breaks.

Our lower-priced loans, several multi-million-dollar projects, have paid off early. They've either sold, and so we've been able to lend out that to higher interest rate products.

I'm excited about a few affordable housing projects that we have in the pipeline. We're in the process of underwriting them. That's been a passion of mine for quite some time because housing is overpriced. I see some of the trend, the housing market is softening a little, but, you know, when I was young, I lived in New York, I lived in Connecticut, and I felt the pains of paying what I perceived as high rents at the time. I'm sure they're much higher now, but, hopefully, these projects will come to fruition. Thank you.

MEMBER DRENTLAW: So we do mainly commercial lending that includes commercial real estate, and then we also have a large mortgage, one- to four-family mortgage department that we sell off our loans to, mainly the Federal Home

Loan Bank.

And we actually had decent loan demand at the beginning of this year. Our pipelines were pretty full. That has really tailed off, I would say, the beginning of fourth quarter, very end of third quarter, where the pipelines are pretty skinny right now. I think part of that is due, like my earlier comments, to people being uncertain with the election but also kind of thinking that rates are going to drop and they're holding off right now to see what the Fed does to perhaps get a lower rate once they do pull the trigger to expand their business.

But even with the strong pipelines, we've seen a drop in our total loan balances. And I think a lot of that has to do with some businesses selling, and so larger loans being paid off that were not expected at the beginning of the year. And a lot of our loan demand has been in lines of credit, as well; and so I think those have not been utilized as much, probably because they're tied to prime with higher rates. And so businesses have held off utilizing some of those lines.

In the one- to four-family market, it was extremely quiet at the beginning of the year. Our demand has picked up pretty significantly, I would say, over the summer into the fall. We've utilized a lot of the programs that the Federal Home Loan Bank of Des Moines at least has put out with being able to offer some lower rates that allowed some people to refinance into the lower rates.

We have an inventory problem in our area for -- well, affordable is way different than what it used to be, I guess. I mean, a 400- or 500-thousand-dollar home is kind of typical in our area now, where ten years ago it was, you know, 250 to 300 thousand. So definitely the higher interest rates have played a part in being able to have people afford a home, but it does seem like there was a slight reduction in mortgage rates, slight, that did start to, like, open up that area a bit more over the late summer - early fall.

We are very conservative in our underwriting, so we have actually zero past dues and have had zero past dues in our Call Report for some time. And we've actually done quite a bit of looking at our multi-family and office space loans. We don't have a lot of them but have done some, I would say, stress-testing or pulling some reports to see what we have and really have strong guarantors or -- they're seasoned loans with strong guarantors in back of them, so we have not seen any sort of deterioration in those portfolios.

MEMBER PLUMSTEAD: Our experience is really rather similar because we're both kind of from the Midwest. And what we tend to see is that things, particularly on the delinquency side but also with rates, will start happening on the coasts first and then it will move downstate, like Detroit and west Michigan and then it will move north. So what we're seeing from banks downstate is delinquencies start to tick up, but we also have single basis points in terms of non-performing assets.

Our commercial loan portfolio, and we're primarily a CRE bank -- that's where our focus is -- was as large as it's ever been over the summer months, and it has tailed off, I think, due to uncertainty maybe around interest rates and the election.

The one area where delinquency has ticked up just a little bit is in our Fannie Mae servicing portfolio, so we originate, sell, and retain the servicing, and that's hovering just about 1 percent.

MEMBER MJARTAN: So continuing a little bit on the theme of my two fellow CDFI bankers there. I'm a little surprised that we haven't seen greater delinquencies because most of our loans are in CDFI-eligible areas, predominantly low- and moderate-income communities. But despite that, we haven't seen any deterioration. Some consumer loans, maybe a little bit, but we were planning for it, budgeting for it, and the models that we used accounted for charge-offs. And we were right on track, exactly what we expected to charge off we're charging off every quarter. So that's been a pleasant surprise.

The demand continues to be very strong. Like I said before, liquidity is the only constraint that we have to meet the needs of our communities.

The office and multi-family, we haven't seen a lot of issues. Fortunately, we stayed away deliberately from a lot of that darn pandemic and afterwards, but we also stressed all of our loans that we did at 400 up for net coverage when we originated them, and that helped us because we were anticipating at some point that those 4.5 - 5 percent loans are going to re-price up, and so we were stressing it early on to make sure that the borrower could handle that expense even at 400 up.

The cost of the insurance, some of us were talking about it last night. We do see, pardon the pun, but a tsunami of trouble coming because those costs are unsustainable. I'm also surprised that we haven't seen a lot of foreclosures related to insurance costs. In fact, we had some borrowers, a couple, they were delighted to get force-placed insurance because it was cheaper than what they were paying before.

So I think there's a significant risk, particularly in Florida and Georgia, the coastal areas of South Carolina and North Carolina, that those insurance premiums doubling in less than five years is just not sustainable. So I don't know how that's going to get resolved, but that could put a lot of borrowers that are performing extremely well, particularly retirees, into a position of default.

MEMBER HUANG: In New York, we're seeing a lot of -- the loan demands remain strong. The larger regional banks and the larger banks that were kind of taking kind of a slow pace earlier this year and last year after Silicon Valley, they've all entered the market strong now that the Fed has made their move.

So they're aggressively pursuing a lot of their customers that came to community banks after Silicon Valley, and they're issuing rates that are much more aggressive than what we can afford. And so we're having a hard time with a lot of loan payoffs towards the end of this year. We've been able to keep some of them, but some of them we just can't keep because our NIM is getting compressed a little too much because our cost of funds are still quite high.

We are monitoring our office, our office and multi-family mixed use, you know. The Class A buildings are really, the large ones in Manhattan, that's not going to affect any community bank. Really, those are the regional, but we did do a lot of Class B, Class C, the mixed use. You know, you're seeing a lot of tenants, we're getting a lot of tenants that they survived the first couple of years of the pandemic but now their leases are coming up, their options years, so they're letting go of some space. And so we've had to work with some of our customers on that.

But to echo over here the insurance part of it. We have offices and branches in south Florida and central Florida. And the largest insurance companies have all left the state. Now, recently, this is already something that's coming up, the state government has their own insurance that's prohibitively expensive.

The governor has already said that they've ran out of money, so the way they're going to do it is they're going to raise taxes and it's getting to the point with, what Lloyd was saying, after Surfside went down, the condo market is taking a huge hit and it's going to get to the point where nobody is going to be able to get a mortgage for a condo in Florida anymore, and the only people buying will be all cash, which is not sustainable also.

So I don't have a good answer for the insurance problem in Florida, but, eventually, and sooner than later, that's going to be something everybody is going to have to contend with because it will bleed to other states.

MEMBER HORTON: In eastern Washington, loan demand has been very strong. We're well diversified in our loan portfolio. On the ag side, I think we will see more carryovers this year and a slower repayment of their operating lines of credit.

On the commercial side, and, again, because of the in-migration into our area, we're seeing just a continued very, very strong demand for construction of multi-family projects, as well as single-family lot developments. We're not seeing a lot of deterioration. We were seeing a little bit of new enticements to get renters in to get to that stabilization, but we're just cutting it off because we're basically over our concentration level, abiding by regulatory guidelines.

So we're seeing that with a lot of banks in our area. Our buckets are full. In multi-family, they're full. In hospitality, the strength of the projects look good. The guarantors are very, very strong. But, again, we just don't have the capacity to do more, so that's kind of disappointing.

As far as delinquencies, we only have about a quarter point of delinquencies and almost no non-accruals. And, again, very few, no charge-offs in the last decade. We're fortunate, the only natural disasters that we're really experiencing out west would be fires, a lot of fire danger. Again, insurance plays into that.

The home loan demand has been kind of modest and weaker, like others have expressed.

And, again, I think that insurance is going to impact that, as well.

So I think I covered most of those. We did a lot of stress-testing, as well, as others have said when we did a lot of our loans, and so we don't anticipate, you know, with the refinancing coming on at higher rates, we think we're prepared for that. Our average commercial real estate loan is about $800,000, and we really don't have any office concentrations. Thank you.

MEMBER BATES: Middle Tennessee is still seeing a lot of influx of investment, even from, you know, out of state. We have historically been a CRE bank. I tell people I've been filling out that form since 2009. I guess that's when it first started. And this last quarter is the first time we've dipped below 300 percent. We got down to 293. But on the flip side, it's the first time our construction bucket has flipped over 100. It got to 101. So we're still managing that. We feel like we can still grow based on our historic experience.

And we are seeing the bigger banks, they're trying to get their numbers down. I guess their multiples are better if they get their CRE ratios down, and I've listened to a lot of earnings calls and that seems to be a big thought process amongst our larger regionals, which has played into stronger demand for us. And I think, moving forward, we're going to see more of that.

Delinquencies remain low. We've had one foreclosure last week. It sold on the steps, and we got everything, including late fees, so the market is still strong for buyers, particularly if it's, you know, decent farmland. They're going to buy it, they're going to buy that up, so we've seen no issues there.

Our only consumer lending we really do are HELOCs, and we started tracking that about two years ago, as our chief credit officer was getting worried about what usage was going to do as the economy tightened. And we've run 39 - 40 percent usage rate on it, so it really hasn't. The fear of it going up, the lines funding up, hasn't occurred, so we feel like we're in a good position to start being a little bit more aggressive in our lending after having laid off here for about nine months.

MEMBER MAUST: With respect to the loan demand, it has, in the market, been very strong. The challenge has been fierce pricing competition from a variety of players in the market, including insured depository institutions but also non-banks, and that's resulted in payoffs sometimes outpacing originations, which has been a challenge then in terms of growing the loan base itself and not being willing to really go beyond, say, the loan pricing parameters that the bank has established at the board and senior management level.

Interesting to hear regarding the stress-testing. We've been using a 400-basis point stress-test in origination process for commercial loans of all types, and that's resulted in an average debt service cover, including term loan review updates, of 160 to 170, and that's on non-owner occupied. And then anything that's global debt service can exceed 200, 210, which is quite high actually and has resulted in -- I would interpret that as maybe a little bit too conservative, you know, in going to market. It's really something that came out of the financial crisis and just that reticence to take on that risk, but it's also resulted in really, you know, dampening of loan growth in the portfolio as a result.

So I guess from the standpoint of what we're seeing in the market, we are seeing upticks in delinquencies, not at our bank necessarily because of those loan underwriting parameters but across the state with respect to pure institutions. And so we've been monitoring that as a bit of a bellwether or at least a canary in a coal mine for maybe where we might see some stress in our portfolio as well; but it's been interesting because it hasn't been in one particular sector. It seems to be, depending on where we're looking at in the state, wherever the concentrations tend to be. So it could be ag, it could be C&I and the occasional commercial real estate, and, of course, consumer loans.

MEMBER BARKHEIMER: As far as Ohio for loan demand goes, for some reason, we're always a little counter-cyclical. So as I told the board, we either lag or lead, I'm not sure which. But first half of the year, we were very slow. Second half of the year, it's really picked up. Our demand has picked up. Pipelines have filled out, so feeling fairly good about the second half of the year.

On the consumer side, we did see a lot of increase in HELOCs, and we saw most of that coming from debt consolidation loans. So we think that's where the consumer stress is coming out. We're still comfortable with the portfolio because we had been seeing the increase in the real estate values, so we think, if it comes down to issues, that we'll have enough coverage there. But we're not seeing an increase in delinquencies at this point. It still may be early cycle-wise before we start to see that.

Very little deterioration or delinquencies on the commercial side. So it's been more a little bit on the consumer side, one-offs on the commercial and ag. So nothing major there.

On the fixed real estate market for consumers, the stuff that we normally portfolio or sell to Fannie Mae, we have been so slow this year, and this has been year two for us that we've had very low sellable loans that we are back up against the 12-minimum requirement for Fannie Mae, and we know this year we're not going to make it. We've already requested another extension from Fannie Mae and pretty much have been told that they didn't think we would receive it.

So we've got, they told me eight loans so far this year. I said there's no way we're going to hit 12 by the end of the year; we know that. So we have discussed what we're going to do with that. We did spend the time to get approved for Federal Home Loan Bank sales, so we've got that as a backup. But as we've been running both scenarios, we found that Federal Home Loan Bank buys less than what Fannie Mae would have bought. So we then have to make the decision as to whether we're going to not make those loans because they would have been available for Fannie sales but not Federal Home Loan Bank or whether we're going to, in turn, figure out how to portfolio those. So both of those decisions are still ongoing.

On the commercial side, for the higher rates, we did stress-test our borrowers, as well, but we didn't use 400. We only used 200, but, so far, we've still been fine on that and not been seeing any problems there.

And the only other thing on the insurance rates, like I said, we'll see as we get into the escrow analysis, since we do all of ours at once, how much of an effect that's going to have on the payments that the consumers hit and how much we're going to have to try to work with the consumers on being able to handle that higher payment amount.

MEMBER DeVAUX: So in south Florida, we're fairly concentrated in what we do. We do CRE, and a lot of that CRE is retail, the small retail shopping centers where you get your nails done, you get your hair done, you can buy your groceries. That's always going to have a pretty good demand.

You know, back in the day, the early 2000s, before the financial crisis, they used to say that the state bird of Florida was a crane because everywhere you looked was a construction crane in Miami. And those condos are now becoming

25 years old, and, back in the old days, the certification was every 40 years. It's not every 40 years anymore. That market has softened. But, generally, real estate prices, which they did everywhere, went up 30 - 40 percent. They've kind of plateaued in Miami. They haven't gone down, except for those older condos.

We had a situation where the certification of a condo, we were not in it, but the re-certification was $60 million. That's how much work they had to do to bring it up to standard, and they voted to sell it to a developer for the value, and mainly the land value, and take a distribution to the owners, provide a portion of that. It was better than paying the $60 million and re-doing the condo, so the developer will knock it down and start over again. Demand for the new condos is still pretty good.

We don't do a lot of stuff. Like, when the rates started up, we stopped construction because most of our construction was spec, and so we know what happened in the financial crisis with spec back in the day. Those homes ended up empty for a long time, and they couldn't sell them.

We don't do HELOC if we don't have the first position. I remember back before the financial crisis, every six months the customer is back in again and saying, well, my value went up $60,000, could I increase my HELOC, can I increase, increase, increase, until the bottom fell out in the financial crisis.

So we don't do one-to-four family domestic mortgages, TRID loans. There's so much regulation in there, and we didn't have enough of that. Eventually, we'll have to get into that, but we do a lot of one-to-four family for foreigners. Almost all of it is in LLCs, and we've never lost a penny on that business. We've been doing it for 20 years, but it slowed down. This year, we are on goal for production. The first half of the year was very good. The second half of the year, we're still on goal for production, but, for loan balances, the payoffs have been tremendous, I think the insurance and I think the rates. And we monitor re-pricing coming out for the next 90 days, and the good customers, we'll actually call them and say, look, your rate is going to 9 percent, we can do better than that. We tried to adjust that.

If they have a payment history that we're not happy with, they call us when it goes up, and then we work out some kind of deal. Well, I'll tell you what we'll do, we'll do this, this, but you have to maintain your payment history better going forward.

So we don't do much ag. We're not in agriculture areas per se. Our locations are in -- you know, the thing about south Florida is you can't build anymore because, back in the day when you could just take more of the Everglades, you can't do that anymore. Most of the construction now is something getting knocked down to build something else, and the traffic is horrendous, absolutely horrendous, and it's not getting any better.

But I think we've seen a slow-down because of the insurance. We've talked about the insurance. It's a really big disaster. We do get once in a while these little small storms that come through and destroy stuff, like the recent hurricanes, and so we're used to that.

But supposedly, the law changes a couple of years ago and the insurance is supposed to be helping because Florida led the nation in insurance lawsuits. That is now coming down, the way they've changed the rules. And, supposedly, if you listen to the politicians or the people appointed for the position, they'll tell you that they're seeing some improvement. I'm not seeing improvement. I've had borrowers come to me and say, hey, look, I can't insure the building. Windstorm insurance is $100,000. They want to lower the loan amount to 50 percent of the land value and not include the building and collateral, and so we'll do 50 percent of the land value, knowing that we still had the building but now they don't have to insure it because it's not considered a part of the collateral. It's just a lot of crazy stuff and people trying to get around it. The only way to get around it is to sell the property, and we've seen a lot of that.

And so I think that covers -- we've had almost no delinquencies. You know, we only do 65 percent LTV, and so customers are not willing to give up their property if they have 35 percent equity in it. And with the prices still holding, we've been pretty good so far in terms of delinquencies. We have almost nothing.

MEMBER PERRY: So we still have pretty strong loan demand. But it's interesting when the client comes in and they're talking about getting the loan and they hear the rate, they're like, okay, well, I'll take it but I'm going to refi as soon as rates go down. So, you know, when rates were lower, we were looking at, well, if rates go up, what is that going to do to this client? Are they going to be able to afford the payments? So we were doing a lot of shocking 400 basis points just to make sure that we weren't getting customers into a situation that they couldn't afford going forward.

But now it's kind of like we're looking at more what is that going to do to the bank when the client refinances? So just last week, we were meeting and talking about how we need to make sure that we have the staff available to process all these refinances if rates, you know, when rates go down, as rates go down. And then what is that going to look like as far as our net interest margin and also our income statement, so just watching that really closely.

The credit issues, you know, I think, because we were shocking things, we made sure that our clients were going to be able to afford the loan. But I think what we didn't really think about was the credit card debt, and we don't hold credit card debt on our balance sheet, but the clients are going out and they're using their credit cards to finance their lifestyle, and so that has definitely put some of the borrowers into a position where they're not able to afford their lifestyle, I guess.

That being said, being a community bank, having those relationships, they want to pay us because they know, if they don't pay us, where are they going to go? Where are they going to get their money, besides more credit card debt which is just so expensive. So I think that, as community bankers, we have that advantage of people wanting to make sure that they do pay their bank so that they've got their bank to rely on when they need money.

And natural disasters, it's mostly just people that have second homes, you know, in

Florida or, you know, in areas that have been affected by the natural disasters. They are definitely struggling with the rising cost of insurance and just trying to figure out how do we manage with those additional costs. A lot of those people, they bought these homes thinking that's going to be their retirement home, and now they're like can I afford my retirement with all the additional expenses associated with the natural disasters. So I think that's probably the biggest concern.

MEMBER RICHARDS: Forgive me for chiming back in, but this is my last meeting so you all can fire me. But just two things that I'd like to kind of throwback at FDIC when it comes to talking about loan portfolios and credit risk and such. One is CECL, you know. It was the most useless thing for community banks ever. It was an exercise that was unnecessary and burdensome, but we're doing it. We're living through it, and we're managing our reserve, you know, we do our calculation each month, and we're over-reserved, and we're fine with just you all letting us manage that how we want to. But my question for you guys is what's going to be the guidance or is there a guidance, there might be some and we just haven't seen it, on, like, taking negative provisions, requiring us to take negative provisions if our reserve gets to a certain level of excess. We've very conservative, so we like a good cushion, but, you know, are there any regulatory expectations coming with regards to how we need to manage our excess reserves and our CECL calculations?

So that's one. And that might not be you all's area, and you can pass it on to whoever.

But the second thing is 1071 --

CHAIRMAN GRUENBERG: They'll be here this afternoon, so you can run that question --

MEMBER RICHARDS: Okay. The second was 1071, which we're talking about loan growth and commercial lending. It's going to have a huge impact on commercial lending, and I don't think in a positive way. So that's something that we're concerned about, and we can talk to the regulatory people about that.

MEMBER CROCKETT: Just a quick comment on your CECL reserve being over-reserved. It's been my experience that the examiners love it if you're over-reserved, but your CPA firm probably doesn't, so they want you to shore up by the end of the year at least. So that's been my experience.

MS. ROY: All right. Thanks for that great discussion. We're going to move on in the agenda. We're running just a couple of minutes behind.

So for our next agenda item, yesterday, we had a meeting of our Minority Depository Institutions Subcommittee. Warren Huang serves on that committee, as well as this committee, so he and Betty Rudolph, who is the director of our Office of Minority and Community

Development Banking are going to provide us with an update on yesterday's meeting. And a big thanks to Camille and Chet, as well.

MS. RUDOLPH: I think this is on. Is it on? Okay. Well, thank you, Lisa. So, briefly, I just wanted to remind the committee that the Minority Depository Institutions Subcommittee is actually established under the authority of the Advisory Committee on Community Banking, so you all are, you know, the subcommittee reports directly to all of you. And the Federal Advisory Committee Act requires that the subcommittee provide any advice or recommendations that it might have through all of you, so that's the reason we're reporting out to you today.

And so just as a reminder, the goals of the MDI Subcommittee are to serve as a source of feedback for the FDIC on our strategies to fulfill our statutory goals to preserve and promote Minority Depository Institutions. We have five statutory goals. The committee provides a platform for MDIs to promote collaboration, partnerships, and best practices, and third, to identify ways to highlight the work of MDIs in their communities.

So we have nine MDI executives on our MDI Subcommittee, and they represent all four types of Minority Depository Institutions and have a range of business models, size, and geography. And those nine members represent about 10 percent of all 99 of the MDIs that the FDIC supervises.

In addition to those nine executives, we have four Minority Depository Institutions represented on this committee. Dominik Mjartan, Robert James, II; Warren Huang; and Lloyd DeVaux.

So yesterday we met, and I'm going to turn it over to Warren Huang to give a brief report out on our meeting.

MEMBER HUANG: Thanks, Betty. At this time, the subcommittee does not have any recommendations for the FDIC but would like to share a brief recap of yesterday's meeting. So, yesterday, we received a demonstration of a new tool the FDIC is releasing called the Minority Banking Opportunity Explorer.

So this tool supports the FDIC's statutory mission to promote and encourage creation of new MDIs by assisting financial institutions to organize groups with exploring potential business opportunities in areas that meet the community-served part of an MDI designation. So the tool can also support existing MDI growth by identifying new branch locations or advertising opportunities.

We also had a presentation like today on current economic and banking conditions and selected financial MDI performance indicators. Similar to our discussion today, we also responded to questions about economic and market risk, as well as loan portfolio and credit risks. And we also had several briefings from FDIC staff on recent regulatory and supervisory topics that we'll discuss later today, as well.

And, lastly, we had a briefing on recent initiatives of Betty's Office, the Office of Minority and Community Development Banking and had opportunities to provide feedback on program operations.

So that's all to report from the subcommittee. And if anybody has questions, let us know.

MS. RUDOLPH: All right. Well, thank you. Enjoy your lunch.

MS. ROY: All right. Thank you, Betty and Warren. Yes. And as Betty said, we're going to go to lunch, and we'll be back here at 1:00.

(Whereupon the above-entitled matter went off the record at 11:27 a.m. and resumed at 1:03 p.m.)

MS. ROY: All right. Welcome back everyone. I hope you enjoyed lunch. For our next agenda item, we are going to provide the committee with several updates from our Division of Insurance and Research.

We have with us today, Kayla Shoemaker, who is the Section Chief in the Division of Insurance and Research. Kayla will begin by covering a Request for Information on Deposits and also provide an update on the Deposit Insurance Fund Restoration Plan.

We also have with us Smith Williams, Nick Frazier, and Jacob Goldston. Smith is the Section Chief and Nick and Jacob are Senior Financial Economists, again all from Division of Insurance and Research. And they will discuss the 2022 FDIC Small Business Lending Survey.

So I am going to turn it over to Kayla now to get us started.

MS. SHOEMAKER: Thank you. Thanks for that introduction. This is on, right?

PARTICIPANT: Yes.

MS. SHOEMAKER: Great. So I'll be starting today with an update on the Deposit

Insurance Fund, which I will also refer to as the DIF and the Fund. So as required by the Federal Deposit Insurance Act, the FDIC has been operating under a Restoration Plan since September of 2020. At that time, extraordinary growth in insured deposits caused the reserve ratio to decline below the statutory minimum of 1.35 percent. And please note that the reserve ratio is calculated as the DIF balance, so the balance in the Deposit Insurance Fund over the aggregate insured deposits across the banking industry at the end of a given quarter.

So the Restoration Plan is fully intended to restore the reserve ratio to the statutory minimum of 1.35 percent within the eight-year deadline required by statute. So that's a deadline of September 30, 2028.

The plan requires that the FDIC update its analysis and projections for the DIF balance and the reserve ratio at least semiannually and if necessary to recommend modifications to that restoration plan.

So just a few weeks ago on October 17th, staff presented the latest semiannual update to the FDIC's Board of Directors, through which we projected that the reserve ratio remains on track to reach that statutory minimum of 1.35 percent ahead of the statutory deadline and as a result, we did not recommend any changes to the plan at that time.

So I am just going to review today a few highlights from that update. So the chart on the screen illustrates the historical DIF balance, which is represented by the blue bars on the chart, and that's footed to the left axis. But then the DIF reserve ratio, which is the gold line on the chart, and fits to the right access. And, again, that reserve ratio is just the ratio of the DIF balance to aggregate estimated insured deposits.

And as of June 30, 2024, the DIF balance totaled $129.2 billion, which exceeded its previous peak of $128.2 billion in the fourth quarter of 2022, which was just prior to those large regional bank failures of the spring of last year.

So growth in the DIF balance and slower than average insured deposit growth in the first half of 2024 resulted in an increase in the reserve ratio of 6 basis points from 1.15 percent at year-end 2023 to 1.21 percent as of June 30 of 2024.

And assessments earned were really the main contributor to growth in the DIF in the first half of 2024. And over that period, assessments earned a total of $6.5 billion, which slightly above the $6.3 billion in the latter half of last year.

So that really covers the numerator of the reserve ratio.

For the denominator, insured deposit growth continued to slow through the first half of 2024, and that was really driven by slower growth in reciprocal deposits relative to the second half of last year but also a decline in insured brokered deposits and sustained slower than average growth in other insured deposits.

So as of June 30, 2024, annual insured deposit growth was 0.8 percent, which was lower than the long-term historical average of 4.5 percent that we experienced in that pre-pandemic period from 2000 through 2019. And that's the slowest annual growth reported since 2013.

So based on these trends and our latest projections, it is worth reiterating again that the reserve ratio remains on track to reach the statutory minimum of 1.35 percent ahead of the statutory deadline.

And reaching that statutory minimum reserve ratio in advance of the statutory deadline really strengthens the DIF so that it can better withstand any unexpected losses and also reduces the likelihood of any procyclical assessment rate increases or an increase of assessment rates when the banking and economic cycle may be less favorable.

So the FDIC will continue to monitor factors affecting the reserve ratio going forward, including, but not limited to, insured deposit growth and potential losses due to bank failures as required under the current restoration plan and will continue to update the board at least semiannually and post those updates for public-facing website going forward.

So I am happy to take any questions on any of that, the DIF or insured deposit balances.

And if no questions, I can shift to our deposit insurance RFI, the Request for Information on Deposits. There we go.

So on August 6, 2024, the FDIC published to the Federal Register a Request for Information on Deposits. The bank failures that occurred last spring and subsequent events really renewed focus by the financial regulatory agencies, banks, investors and the general public on deposit insurance coverage, bank funding concentrations and also certain bank's reliance on uninsured deposits.

And while banks are required to provide certain data on deposit liabilities on the Call Report, they do not report comprehensive data on the composition of insured and uninsured deposits nor the characteristics of those deposits. And as a result, the FDIC does not have historical data on banking industry trends for different types of insured and uninsured deposits, including how depositors would behave in times of stress.

So through this request, the FDIC is seeking information on the characteristics that could affect the stability and the franchise value of different types of deposits.

The FDIC also seeks information to further evaluate whether and to what extent certain types of deposits may behave differently from each other, particularly during periods of stress for both economic or financial.

So the request also seeks comment on whether more detailed or more frequent reporting on the characteristics or types of deposits could inform a number of policy objectives, including enhancing offsite risks and liquidity monitoring.

And in an effort to better understand and inform analysis of deposit balance trends, which is a factor again that affects an important measure of the DIF with the reserve ratio and potentially to improve risk sensitivity in the deposit insurance assessment system, the request includes questions on how banks measure or evaluate the stability of different types of deposits and more generally on what additional data, including more granular or more frequently reported data, should be considered for collection.

The RFI recognizes that other regulators and stakeholders may also benefit from additional information on deposits so the request additionally includes questions on whether more detailed or more frequent reporting on the characteristics or types of deposits could improve the accuracy and transparency of data reported on the Call Report or other regulatory reports to better inform analysts and the general public.

Finally, the RFI recognizes that additional data on deposits could also inform analysis of the benefits and the costs associated with additional deposit insurance coverage for certain types of deposits.

So you may recall that in the spring of last year, the FDIC published a comprehensive report. That was in May of 2023. And that was entitled, Options for Deposit Insurance Reform, which outlined three options for Congress to consider to reform the nation's deposit insurance system because that would take an act of Congress. And that was to inform any discussion around any potential increases in deposit insurance coverage.

The request includes questions on those options, including the definition of business payment accounts and any challenges associated with reporting new deposit items on accounts linked to payroll, vendors, or operations.

So the comment period for the RFI has been extended by 60 days, so it closes on December 6, so just under a month from now. And of course we welcome any comments from all interested parties going forward. So any questions on the deposit RFI or anything I've covered?

MEMBER RICHARDS: A couple things. One is this request for further information will get us away from the old-fashioned definition that we've always had of volatile deposits, which doesn't make sense in the world today that a checking account with $4 million is considered non-volatile. But a CD that's got 300, you know, that's considered volatile regardless of how long the CD has been there.

So to me it makes more sense to try to measure how sticky the deposits are out of institutions. If this is an effort to get to that sort of a definition, I think that's much more meaningful. Because as you all saw with SVB, you know, money can disappear, you know, quickly through technology. So I'm glad to see that. We need to get away from that old definition of what a volatile deposit is.

Secondly, on the insurance fund, the recent bank failure that we had where it was announced that depositors would be insured 50 percent on uninsured deposits, I don't understand that because we have insured deposits and uninsured deposits.

How does a bank get in that category of having its uninsured deposits insured up to 50 percent when I don't think our bank would get that treatment? I mean, is there some sort of a threshold limit or, you know, where that gets decided on would be my question to you guys? And don't try to answer it.

CHAIRMAN GRUENBERG: Let me try to help out there.

The way it works is that if you have an uninsured deposit, it doesn't mean you lose it all. It means those deposits are subject to loss depending on the loss to the institution.

So as we go through the assets of the failed bank and see what kind of return we get, that's going to determine -- see what the loss on those assets are, that's going to determine how much of your uninsured deposit you can get back.

So in the case of this institution, and I think we tried to make it clear in the announcement, the estimate is that they would be able to recover at least 50 percent of the value of the assets of the institution so that we could offer the uninsured depositors access to half of their funds upfront.

And then as we indicated as we go

through the assets and get a better sense of the valuation, that loss may go down further. So it's really simply passing along the losses that the institution presents to the Deposit Insurance Fund to the uninsured depositor. That may be 75 percent, 50 percent, 25 percent, or whatever. So that's really how it works.

MEMBER RICHARDS: I just think it gives that impression, at least initially, that this is the old too big to fail kind of concept, which we struggle with because, you know, we're trying to keep deposits at our bank and not lose them to banks that are too big to fail that would have better coverage than we have.

And so I think whatever you all can do to not give that impression would help. And, you know, as we get more information on the uninsured deposits, I think uninsured versus uninsured is a great thing for us to be aware of. And we didn't

start doing that until, you know, after SVB. But we run a report every month now to see how our uninsured number tracks. That's more meaningful.

But we get our number, and I think I said this last time, was, you know, what do we do with our number? How do I know, is this a good number or a bad number? So I would hope that FDIC would then turn that information around and send the banks information on, so we kind of see where we stack up, you know. Are we doing okay on that insured? And not wait until an exam for a regulator to tell us, but really some data that we can say, well, you know, we're kind of behind the 8-ball on this. We need to beef this up or not. But anyway, that's my two cents.

MEMBER DRENTLAW: I'd like to add to that because we also started trying to track our uninsured deposits. But I am going to say it's difficult a bit. I mean, we're kind of looking at the customer's social security number basically and looking at the aggregate of anything over $250, which really isn't completely accurate because of how you can structure accounts.

So the one concern I have, if we have to start reporting something more granularly on a regular basis is that we are going to have to try and figure out with our core vendors how to possibly track that because of how things are structured with, you know, pay on death and that kind of thing. It might expand your insured to more than what a simple report comes out of.

And so right now, I think we are overestimating how much we have as uninsured. It gives us an idea of what we have. So it is conservative, definitely. However, if we have to get to the point where we are examined on accuracy of that on our Call Report, it might need to take more time just because we are going to need to really rely on our core vendors to be able to help us create something that will allow us to code things the correct way and aggregate it.

And I don't know about other people,

but I don't feel like we're at that point with our core that it would really do that without some manual process each time.

MEMBER DeVAUX: So I would echo the comment of, you know, what we saw was a flight to safety and that's a disadvantage for community banks. So as we go through this process, it seems to me there has to be a way to prevent that flight to safety because it just creates more and more problems.

And the other thing, there was some discussion about particular types of deposits, like a payroll account. A company has a payroll account. Really? I mean, we're not going to insure that?

And I know there's issues there because if they have a payroll account, we say it's insured. Then they have a money market. They move all their money to the payroll account on the last day because the bank's in trouble and trying to protect all their money. But there's things like that we need to be thinking about.

CHAIRMAN GRUENBERG: Now, listen, thanks for mentioning that, if I may say, on both of those points.

You know, in the wake of the regional bank failures last year, there was a lot of concern about deposits leaving smaller banks and going to the G-SIBs, the global systemically important banks, on the premise that your money was safer there. Those institutions were unlikely to fail.

It's interesting. It got a lot of attention. But as an actual matter, because we obviously track these things through the quarterly banking profile, we had some limited evidence of that in the second quarter of last year, but after that, not really.

So the notion that the -- and community bank liquidity remained remarkably stable. So as near as we could tell, I don't know what your individual experiences were, but in the aggregate, we didn't see community bank liquidity being particularly impacted.

The regional banks had some issues not surprisingly given that it was three regional institutions that failed. And there was some loss to the banking system. But it wasn't going from smaller banks to the bigger banks. It was going from banks to non-bank mutual funds that were paying higher rates at the time. That really seemed to be the driver in that whole episode.

On the business payment accounts, we actually sort of agree with you on that. You know, after the bank failures last year, there was a lot of talk, as you recall, about making changes to the deposit insurance system and not all of it based on factually accurate information, you know.

So we directed these folks on a painfully short -- to some degree our people have been waiting around to do a report, you know, on deposit insurance and changes that might be made.

But I think they would have expected, you know, maybe six months to a year to do a report like that. So when we asked them to do it in 30 days, their enthusiasm went down a little bit.

But because of the urgency of the moment, and I will say they did a remarkable job. And if any of you have had a chance to look at that report, it's really thoughtfully done. And if you haven't, I recommend it to you because it's a real good primer on the deposit insurance system and options for changing it.

And the report identified three options for changing the system. One would be some adjustment in the deposit insurance limits from $250,000 up to some other amount, whether $500,000 or a million. That would cover some additional depositors, but frankly, let me put it this way, the top 10 depositors in Silicon Valley Bank held, this is hard to believe, $13 billion, with a B, in deposits.

So from a financial stability

standpoint, you know, a marginal increase in deposit insurance coverage wouldn't have much effect.

Now you can go to the opposite and say, well, let's insure all deposits and basically put the banking system so that we feel sort of the same way about that. And it would be -- it would really remove all discipline from the system. And it would be a moral hazard to an extreme obviously, and you can imagine if we wanted to maintain the fund as an industry supported fund, that would be unviable.

But the place where we thought that there might be some possibility was business payment accounts because, one, they're really valued by both particularly small businesses and the banking industry. Two, by their nature, they're operational accounts. So you're going to -- that's an account that you're going to keep at one institution. By definition, you can't spread that across banks because then operationally, it won't work. And people really don't look at those type of accounts for a return. They're really looking at them for operational purposes.

So from a moral hazard standpoint, we didn't see a lot of risk. From a financial stability standpoint, if you've got payroll accounts and people aren't receiving their paychecks, then that could really have an impact on a community or depending on the size of the institution, a broader consequence.

MEMBER RICHARDS: Is there a concern though, when the payroll account, that there would be gaming of the system?

CHAIRMAN GRUENBERG: Yes.

MEMBER RICHARDS: And then I would be worried, you know, how to report on that. Like what are the criteria? How many debits? How many do you have to have a month? Is it a year? What are those going to look like? And then you're just going to have people say well, I'll just do -- I'll write 10 checks out of this account so I can get unlimited insurance on it.

CHAIRMAN GRUENBERG: No, it's a fair point. And we actually flagged it in the report that it would be a real -- a key issue would be definition of what would qualify because it really opens up the potential for gaming the system.

So I think we would have to give some thought to that. We would want to get public comment on that if we went down this path.

But from a deposit insurance standpoint, higher coverage for business payment accounts makes some sense from a policy standpoint. And then how high the coverage should be in part is going to bring in considerations of the cost to the industry because obviously the higher the coverage the more consequence it would have for deposit insurance assessments.

And we can do some analysis on that,

to sort of show what the cost might be and, you know, where a reasonable level -- what level might be, you know, make some sense. But conceptually, we think it has the most potential in terms of increased deposit insurance coverage. It would also, you know, require legislation from the Congress to change the law.

And, you know, initially, there was a lot of interest in the aftermath of the failures. As things calm down, the interest in changing deposit insurance also calmed down. So I don't think there is anything imminent. But I think there is bipartisan interest in the business payment account option. And it is something worth looking at. So thanks for mentioning it. In some sense, just looking around the table here, there is some interest in that approach.

MEMBER DeVAUX: Well, and just two quick comments. One is -- I understand there wasn't a migration, but of course the contagion didn't take effect like a lot of people thought it might. It slowed down. But we still have customers who very meticulously structure their holdings to make sure. So that's already a competitive disadvantage for banks because they don't want to leave that much money with us.

And secondly, we've had customers say to us, I can't leave that much money with you because you're too small. That's why I'm saying if we didn't have that issue, it would help the community banks a lot more so.

CHAIRMAN GRUENBERG: I appreciate that.

MEMBER SHOEMAKER: Additionally, community banks rely on public funds to operate. And I hope that the FDIC on the request for information continues to give public funds due consideration.

CHAIRMAN GRUENBERG: And that's one of the things we want to -- it goes to the point of differentiating deposits that fall into the uninsured category, you know, government deposits, collateralized deposits and uncollateralized deposits, things we don't currently have data on, and we really want to understand that on a more granular level.

MEMBER BATES: That would be helpful because we do several large operating accounts with municipalities. And typically, we have four-year contracts. So the money is stable even though it's pretty large. But, you know, it's all collateralized.

And even when we have lost a large one before, and it took at least nine months to actually from the date we lost the bid until they could actually move the money, so we had plenty of time to figure out, you know, an ancillary plan.

MEMBER PLUMSTEAD: I think something else to consider is that there is a variety of terms that have become, well, morphed and antiquated over time. So what's a core deposit? What's an internet deposit? What's a brokered deposit? I know that we'll get on to that topic later.

But something to think about is to redefine the categories by product type, depositor type, delivery channel, and then to potentially put concentration limits and track those on the core and then potentially report those on the Call Report.

But as Anita pointed out, it's going to take some time if we go down that path for community banks and their cores to adapt to that. But there's just a jumbled set of terms and terminology out there that I don't think is as useful anymore.

MS. SHOEMAKER: If no other comments, then I'll pass it over to Smith on the small business lending survey report.

MS. WILLIAMS: Thank you, Kayla. So I am very pleased, and we as a team are very pleased to have some time, a little bit of time to share with you just a preview of the report of findings from our 2022 Small Business Lending Survey. It's a very thick report. There is lots of information. I encourage you to go and take a look at it for those details.

But since we only have a very little bit of your time, I am going to quickly hand it over to Jake and Nick, who are the primary authors of this report.

MR. GOLDSTON: Thank you for allowing us to have some time to present.

So I don't think we need to go over too deep in too much detail the motivation and the context of this survey. Because this is something that you guys all know very well. Small businesses are very important to the economy, and banks are really important source of financing for small businesses.

And these studies have taken place in sort of two -- there are two trends that we were interested in understanding as we did the survey or contextualizing our survey.

One is that the banking industry continues to consolidate with more deposits being put into -- more assets being concentrated at larger banks. This is a process that's been ongoing, and it's something that we are interested in understanding what the consequences might be of that.

And then, in addition, there has been changes in the competitive and technological landscape, sort of particular, there has been, in particular -- there we go -- in particular, there has been an increase in fintech. And this is both fintech as a competitor, for a fintech firm as a competitor to a bank in the small business lending space but also fintech as used by banks in the small business lending space. So that's something that's going on that we will be focusing on. We focused on a bit.

And the SBLS 2022, historically, there has not been a lot of high-quality data on small business lending. We did a previous version of this survey in 2016. And the 2022 one sort of tries to builds on the success of that.

I think I hit the thing twice as I was simply told not to do. So let me switch forward here a little bit. So one of the things we really want to focus in on here is how do banks make small business loans? So understanding the decision-making process that goes into this. What kind of relationships do you use? What kind of markets are banks operating in? And what kind of information is being used in the underwriting process.

So that's -- we're trying to sort of get into the guts of the small business lending process at banks rather than just ask how many loans you made. We're trying to go a little deeper than that.

So just as a very basic understanding of the SBLS, the data was collected in 2022. In some cases, the questions were referenced of year 2021. For instance, a question -- well, one of the first questions we ask is did you make any small business loans in 2021? Because we wanted to be able to get a full calendar year of, you know, information there.

The survey sample was drawn to be nationally representative. So this means that every bank in the country had some chance of being selected for the survey, which means that we can use this to make inferences about the whole industry.

It's a very large survey. We sampled 2,000 banks and got responses from about 1,300. So I cannot legally say if any of you responded to the survey. But I can say that statistically between three and four of you did and statistically we thank you.

So we had a high response rate of 68 percent. This is very good for a survey of this kind, and we are very happy with that. And we work very hard on that, particularly Yan Lee, who was previously working on the project. And this was an improvement over 2016.

All right. So there were a few definitions I just want to make sure that we're clear on as we go through the survey and the results and then we can start talking about what we found. That's what we found.

So banks were encouraged to use their own definition of small business. So if we asked you, you know, when you do small business lending, you know, what kind of small business lending do you do? We didn't tell them that it's a million dollars in revenue or something like that. And we didn't tell them to adhere to any regulatory definitions. We said use your own definition of small business. And that could be all the businesses you lend to. It could be small in your opinion.

The kind of lending we're interested in is what we call business purpose lending. And that is inclusive of both C&I and also owner-occupied CRE. So anything that you sort of -- if you're building a plant for your own use, that's something we consider to be business purpose.

If you're building a shopping center to lease out to other people, that's not business purpose.

The results that we show are for the banks that made small business loans. So 94 percent of banks -- we found that 94 percent of banks did make at least one small business loan in 2021. And these banks answered the whole survey.

If you said you did not make a small business loan in 2021, you were excused from answering the entire survey. So when we present the results here, you should be thinking about -- this is as a -- the 94 percent of banks that do this, not the 6 percent of banks that don't.

And finally in most cases, there are questions excluded credit card lending and government-guaranteed lending as well as PPP. So these types of lending are important, and we do have some questions that focus on them. But we decided that we did not want that mixed in with the sort of more general traditional lending because they are conducted very differently.

So that's just to give us a baseline for understanding as we go through these results what they mean.

So the overview of findings here, we found that despite, you know, technological innovation and, you know, time progressing forward and the pandemic, we still found that the basic nature of small business lending has not really been affected that strongly by technology.

Small business lending is still very relationship oriented. It's still very much about a face-to-face relationship. It's still very staff intensive. People are still in the loop on these decisions. It's not all being done by computers. It's not all being done automatically.

And it's still very -- and related to these two, it's still very branch centric. The branch is still the primary locus of activity for small business loans. It has not been outsourced entirely or gone online entirely. And that's, you know, something that is perhaps a bit surprising in the wake of the pandemic and all of, you know, the effects that it had.

Another key thing that we found is that there are some differences between small and large banks and particularly how they manage their smaller loans and their startup lending.

So one thing that we found is that small banks are more likely to use soft information more than large banks. And that's something that we sort of predicted by economic theory, and it's sort of good that we found -- it's supportive and good that we found this. But it is certainly very interesting, and especially if we are considering a world with fewer smaller banks that's something that we might lose.

And we also found that larger banks tend to do more credit score-based lending and do more automated lending.

So we're going to go through a few findings here. I am going to cover Finding Number 1, where we talk about soft information and then Nick is going to cover Findings 2 and 3 about technology and about the branch locations.

And there is a lot more in the report. This is a very small sample of what's available in the report.

So this chart is looking at the amount of information used by banks of different sizes in their underwriting of loans of different sizes. So what we did here, is we asked banks about 12 different categories of information that you might be interested in for a loan. So things like credit scores or the business plan or what a loan officer gets out of an interview or certain financial ratios. And then we asked how often or how commonly do you elicit this information for a loan of this size?

So we asked for $25,000 loans, $250,000 loans and then loans of $1 or $3 million. And then we just create a score that goes from 0 to 100, where 100 would indicate that you asked about all information for all loans of this size and 0 would indicate that you ask for none of this information for any loans of this size.

And so this is plotting this for small banks and large banks, throughout different loan sizes. And there are two things that jump out about this chart.

One is that small banks are consistently using more information than large banks. Small banks seem to be gathering a larger type information for more loans at every loan size.

And in addition, as loan sizes go up, you see that both small and large banks are gathering more information. And this is consistent with what you would expect because small banks, for any given size of loan, are putting more of their asset -- you know, more of their total assets at risk, more of their total value at risk for this loan. And as you get bigger and bigger loans, both large and small banks are putting sort of their assets at risk for this.

So this may just reflect, as you put more at risk, you ask for more information so then you can be more sure that the loan isn't going to go bad.

Now in addition, we took this information, and we said, okay, we have 12 types of information. Let's sort them into what we call soft information and what we call hard information.

Soft information is the kind of stuff that's very hard to put on a spreadsheet. So the information you get from an interview with a loan officer or a business plan or the identity of the advisors to the bank. That stuff requires a lot of context. You can't just, you know, throw it into a spreadsheet and add some stuff together.

For hard information, it's the opposite. This is the stuff like credit scores or financial ratios that you really can sort of plug and chug.

And what we find here is that on the left-hand side we have the soft information score, the right-hand side the hard information score. And we find a consistent gap in the soft information score between small banks and large banks.

Small banks are really using a lot more soft information than hard banks. And this is true at every loan size. But for the hard information, we see very little gap.

So this is, I think, a very -- you know, this was something that really, really jumps out when you look at this, right? This is a very big gap. And this is something that small banks really are bringing to the table that large banks are not doing nearly as much of.

And this is a consequence if you are a small business, and you have good soft information but bad hard information. You know, you don't necessarily have all of the hard information that you need, but you have a lot of -- you know, you can present your business plan very well. You know, you can really explain to the loan officer this is a good idea.

If you're a small business and you go to a small bank, you might be able to get a loan there. But if you go to a large bank, that's not going to count for as much because they simply aren't looking for it nearly as often.

So the other type of behavior that we thought was very important and interesting, is we found that small banks are much more likely than large banks to have people meet directly between not just a loan officer necessarily but a decision-maker at the bank and the applicant.

So 89 percent of small banks, nearly all small banks do this. This is just very standard practice. But for large banks, only 39 percent do this. So for a large bank you go in there, and you never get to talk to somebody who is going to actually make a decision about your loan.

And this grading becomes even steeper for the largest banks, which is something that we show in the report. And so we think this is another way that small banks are utilizing soft information.

And we also found -- sorry, it's going all over the place -- that large banks are more likely to emphasize credit scores, particularly for smaller loans. I won't go into detail on this because we are low on time. But we found that for larger loans, both small and large banks tend to emphasize financial position as most important. But for the small loans, large banks tend to really focus in on credit scores and other information from credit bureaus, which is a very different way of looking at underwriting a loan.

And now I'm going to turn it over to Nick.

MR. FRAZIER: Okay. I'm going to beg your forgiveness a little bit. Let me try and hit the headlines rather than walk through all the graphs just for your time.

So we also looked in the survey about the use of technology, specifically in the small business lending context. And we learned that not only are our banks using technology but how it's changing the overall process of making loans to small businesses.

Our first result here is going to be that over half of banks are either using fintech, and this is just specifically for financial technology fintech, either using fintech or considering its use.

I broke the loan process down into 10

different steps. And what we see there in the graph that the most common step is going to be for regulatory compliance, assisting regulatory compliance.

The other thing I will point out is that most of the uses of fintech in the industry are for things after the approval decision. It's for things like portfolio analytics and servicing.

The other question we had in this was how is fintech changing how banks interact with their customers. And we find that for these kind of core relationship product tests, like having the loan officers form a relationship with borrowers, having them give advice, having them do things off premises, there's really no difference between the banks that use fintech right now and the banks that have no plans to use fintech.

Relationship lending is there. It's a key part of small business lending and technology isn’t used to supplant or displace, at least as of the survey those practices.

Turning now to markets, we looked at -- just a second. Turning now to markets, as Jake foreshadowed, it's still very much about the branch and an emphasis on in-person interactions, which might not surprise you if you’ve been listening so far.

Eighty percent of banks, this is community banks and large banks, 80 percent of banks define their small business lending location, which is where are your small business borrowers located around their branch footprint? If you don't have a branch there, you probably don't have many small business borrowers from there. And for those banks, the average distance from their branch is about 40 miles.

The top factor limiting banks, the nice thing about surveys is we can dig a little bit deeper. We ask banks, why doesn't your market go a little bit farther? It's going to be competition. When you get too far away, it's difficult to form those relationships, and the borrower ends up going to a different bank.

And another way we know that branches are important is we asked about online portals for taking applications. And so here at the bottom, we have only 6 percent of banks -- only at 6 percent of banks in the United States can you apply for a small business loan entirely online.

At 34 percent, you can do some of the steps of an application, like submitting documentation. But at 60 percent, none of the steps can be taken online. It's still very much in-person, at the branch, or through a site visit or through -- and we go a little bit more in the survey report into things like email or telephones or videoconferences.

But kind of a fun fact from the survey is that -- in this graph we're going to ask how do you value this method for interacting with your small business borrower, whether conditional and whether you use the practice yourself as a bank or do not?

And for online applications, we see that banks that -- even banks that do use online applications, they don't find it nearly as valuable. It is much more likely to find it as valuable as these banks that use branch -- take the applications at branches or through onsite visits.

Okay. I want to thank you again for your time. And we are happy to take any questions. There is a full report online. And we appreciate any feedback.

MEMBER REIGELSBERGER: I have a quick question.

MEMBER SHOEMAKER: Go ahead.

MEMBER REIGELSBERGER: Kind of as I read through this and listened to you, working in the bank, none of this is new to me. What do you do with this information? Who uses it? Why are you doing it? I mean, I guess, that's my point is it's not new to probably any of us in here. So I don't know - you guys spent a lot of time on it. What is the information used for?

MR. FRAZIER: So one thing that we talk a little bit more about in the report is the difference between small banks and large banks when you are talking about Jake's motivation of continuing consolidation. What does it mean to not have a community bank nearby?

And one of the things it might mean in Jake's very nice presentation was it might change the kind of information that's relevant when you submit a small business loan application.

And if you don't have the kind of hard information that a large bank needs or typically uses, it may be harder for you to get access to credit.

MEMBER SHOEMAKER: And I wanted to say that I commend the FDIC for the scope and quality of this report. I thought it was fantastic.

I am a census track person, demographics. I like research. And I found it to be a -- although the 2020 census, you know, that's still not very favorable with bankers. But I am using it as a tool for marketing, for future planning, for budgeting because it really validated the things that we already knew. But it also allowed us to prioritize some of our projects. So I thought it was fantastic.

MR. FRAZIER: Thank you.

MEMBER DeVAUX: So let me ask a question here. So you have all this information. Have you tried to compare the efficiency of scoring versus non-scoring, approval rate versus denial rate on scoring versus non-scoring and default rate, you know, charge-off rate of scoring versus non-scoring?

I mean, it would be interesting to know because you've got such a big database. Is scoring really a good model? And if it is because, when you look at the size of the loans, community banks are mostly going to be in the smaller loans.

And if those work for scoring where we could reduce some of the resources, that's 40 percent of the bigger banks meet the customer where 90 percent of the small banks meet the customer. And that's important when you still meet the customer.

But scoring versus non-scoring would be something that I think would be valuable. And then charge-off rates versus denials and approvals, things like that, was any of that looked at?

I know it wasn't really the purpose of the study, but that would be interesting.

MR. GOLDSTON: That's certainly an interesting thing for us to do in the future. We're obviously -- you know, the report is pretty long as it is. So we couldn't get into too much detail.

I think one limitation of the data

that we have is that we don't have loan level data. We have, you know, does your bank do credit scoring? And then we could look at the, you know, charge-off rate at the bank level. But it would be really nice to have.

And as an economist, I can rattle off a million types of data I'd like to have. It would be really nice to know within the same bank the scored loans and the non-scored loans and different charge-off rates. But that's an interesting avenue, and I think that's certainly something that we could do going forward.

MEMBER BATES: I know we focused on just big bank and small bank, but what I'm saying, I mean, obviously, we can -- you know we can do loans that big banks can't do because they've got a national box, you know. And that's what gives us our advantages is we have that local knowledge.

But what we're seeing is more non-bank lending, you know, like the Squares of the world providing. So we're seeing a lot of financing from places that we've never seen it before. You know, we're running into that more and more.

We're very active in the treasury market. But when we go in with our merchant processing, we're finding that these non-bank companies are tying people up with their systems. You know, it's like they have all these medical practices. They're only systems. But then they got to use their credit card process and then they start making them short-term loans. I see that as a bigger threat.

I mean, the big banks, they're our best friend, you know, because they don't want to mess with the loans. Our biggest challenge is how do we make those loans -- how do we automate those and still have the personal service?

And that's what we're working towards is being able to automate loans under, you know, about 250 but still have the front-facing decision-making but being able to automate it so that it didn't take as much time because they want their money now. They don't want to wait a week or 10 days for a small business loan.

MR. GOLDSTON: That's certainly consistent with what people were saying about the use of fintech in the post-decision-making process. But, yeah, we certainly have stuff in the report where we discuss competition with fintechs. That was one of the last things we cut from this presentation for time purposes. But I would recommend if you're interested there's some stuff on the trends there.

MEMBER DRENTLAW: So I know that we are a little short on time. However, I do want to make mention of one of the comments, Nick, that you made that banks, community banks, use a lot more soft information, not so much hard information for making loans.

So as I listened to this, and I think of the upcoming 1071 rule, it concerns me a bit as to how smaller community banks are going to be able to take that data -- if we're serving a population that might not otherwise get a loan just based on hard data because we have other stuff surrounding our decision-making process, yet we're going to have to report somehow all of this data in for small business loans that we're making.

It seems to be somewhat of a disconnect for me. And I realize that it's, you know, Congress that passed this law. And we have to implement it, and you guys are not the governing body over the final decision and stuff.

However, I do feel like this is so important because it is exactly how we conduct our business. We don't do everything just based off of pure ratios all the time. And we structure loans differently because of how the business is structured.

So as that rule gets implemented, any sort of leeway, I guess, that the FDIC or any other regulatory body has when it comes to examining us on it is really going to be important to understand this data because it's going to be hard for us to somewhat comply with it so that we're not not making the loans then in our community because we have to fit them into a box.

MEMBER RICHARDS: You know, I wanted to piggyback off of the 1071 comment. It would be great if FDIC could share this with CFPB and maybe it has some influence on what they consider to be a small bank or, you know, that threshold amount for loans that would force us to comply with 1071.

I would say that if 1071 goes forward and we don't get any relief from it, that when you do that survey again, it's going to be a lot different the next time because it's going to fundamentally, I think, change the landscape of small business lending in our banks.

We're going to be so worried about a fair lending exam coming out of 1071 reporting that we're going to have to standardize commercial lending like we do consumer lending, and those are two different animals completely.

There's no two commercial loans that are exactly alike. That's why they don't pool commercial loans together and sell them like they do consumer mortgages. So it's going to take a lot of the creativity and subjectivity out of commercial lending that's just frankly part of the process.

And it's through that soft data where we, you know, live and work and go to church with all these folks. And so we know their businesses. And so that's a lot of soft data that you can't put in a spreadsheet.

It will be interesting to see how this data will change if 1071 goes unchanged.

MEMBER MJARTAN: If I can make just a quick comment. I do want to recognize the tremendous work. I think this is a fantastic report. I think -- I mean, I was not surprised by anything. But it is really a great validation.

And what you're describing, I think it's -- what jumped out at me is the grave threat to the viability of the entrepreneurial system in America that consolidation in these fintechs actually pose, right?

So if you look at this exactly to your point, if we start removing the soft information, you know, what's happening to us, I see more and more, even point of sale lending, the easiest loans to make are being taken away by large banks or these fintechs. They are the easiest ones, the quickest, the most standardized. Their credit score, limited collateral, digital lending portals.

So what our banks are increasingly left with is the most complex small business credit. To your point, nothing is alike. But that's where the economy is built, right? It's built on those imperfections that exist in our communities, not in those perfections. Everyone with an 800 credit score and $10 million liquid net worth can get a loan. But that's not where we live. We live in a completely opposite socioeconomic spectrum.

So I think the use of this report would be incredible if it could be used to point out those risks and what the regulators can do, not to pick on 1071. Look, I'd love to see the data from 1071, but it also introduces great risk again because it will force us to standardize and the same reason we don't offer non-QM or QM mortgages because of the risk. So that's my comment on it.

Years ago, the FDIC did, and it may be one of the studies that Chairman Gruenberg championed, showed that the proximity of the branch and the lender to the small business correlated with access to small business credit. And for the last 20 years, I have not been able to find that report.

So if you can help me find that report, I would love it. I bet that report would still be valid and accurate just as it was 20 years ago whenever that last date was from.

CHAIRMAN GRUENBERG: I think they have it. I think they do.

MR. MJARTAN: So if you could share that because I've been trying to use it to make the points that even though we are not a branched bank, we are single branch with $650 million in assets.

We're still doing a lot of relationship lending. The proximity of the lender to the borrower, whether it's virtual or physical still does matter. And this report points it out. So thank you for the amazing work. Really great stuff.

MEMBER PERRY: At our bank, just kind of for the fun of it, we went through and exercised to see what it would look like if we just used a model to price all of our small business loans. And I've just got to say that, you know, it's hard to put soft information into a model. I don't think we would be making any loans because I don't think the borrower would take the loan, you know, if it was just based on the hard information.

So, you know, we've got a great relationship with many of our small businesses. And the reason we do is because of the relationship. It's because of all that soft information. And the soft information and also the competition, you know, that you're looking at when you're looking at pricing a loan, that's what makes it affordable for these small businesses.

So it is, you know, I think that -- so we scrapped our model. And we went back to doing it the old-fashioned way. We never actually used it. We just were looking at it to see what it would look like. And it looked awful, so.

MS. ROY: All right. Well, thanks to Kayla, Smith, Nick, and Jake for that presentation.

We're going to move on to our last presentation of the day. Our final agenda item, we are going to provide the Committee with an update on several supervision and policy matters.

Our first panel is going to cover two items. A proposed rule on requirements for custodial deposit accounts with transactional features and prompt payment of deposit insurance to depositors. And we're also going to cover a statement on third-party deposit arrangements.

So joining us for these two items to discuss them, we have Luke Brown, who is an Associate Director, Supervision Policy Branch of the Division of Depositor and Consumer Protection. And joining Luke is Meron Wondwosen, Assistant Director in the Division of Depositor and Consumer Protection, Sumaya Muraywid, Section Chief in the Division of Risk Management Supervision, Jake Meyer, Senior Claims Administration Analyst with the Division of Resolutions and Receivership and James Watts, counsel with Legal Division.

I'll turn it over to you, Luke.

MR. BROWN: Thank you. Is this on? Good afternoon, everybody. It's great to be here. I hope that you're having a good day.

Our presentation today focuses on proposed rulemaking that the FDIC recently issued to establish new standards to strengthen the recordkeeping requirements for certain FDIC insured banks.

The proposal covers deposits received from non-bank companies that have accepted those deposits on behalf of consumers and businesses. The proposed rule is intended to promote the FDIC's ability to promptly make deposit insurance determinations in the event of a bank failure, enabling the FDIC to pay deposit insurance claims as soon as possible following that failure, which is an obligation the FDIC has per law.

The proposed rule is also expected to benefit consumers and depositors by promoting timely access to funds that they have deposited at banks, even in the absence of a failure.

By issuing the proposal, the FDIC seeks to protect depositors and promote public confidence in insured deposits. With that, I will pass the presentation over to Meron Wondwosen, who will provide you with more details. However, after the formal presentation, we look forward to having a conversation with you about the proposal. Thank you very much.

MS. WONDWOSEN: Thank you, Luke. Good afternoon. The FDIC Board approved the issuance of the proposed regulations on September 17, 2024. Deposit taking in the financial services industry has evolved resulting in insurer depository institutions gaining access to deposits through third parties in increasingly complex relationships. These changes created new options to deliver financial products and services to consumers; however, they've also created risks for consumers including confusion regarding the applicability and availability of deposit insurance to protect their money from loss.

The risks that can be presented by certain custodial account arrangements have also been underscored by the recent bankruptcy of Synapse Financial Technologies, Incorporated.

The proposed rule is intended to address the ongoing transformation in how financial products and services are being delivered to consumers. Coupled with technological innovations and advancements, custodial deposit account arrangements have transformed the industry in many respects. Increasingly, many consumers are choosing to open deposit accounts online or through mobile applications and directly through non-bank companies, as well as to make purchases, send or receive money, and pay bills. These non-bank companies' accounts at banks often, though not always, are established as custodial deposit accounts. These deposit accounts can hold funds of many thousands of consumers and businesses.

These developing arrangements involving non-bank companies have created risks for consumers including confusion and uncertainty regarding whether their deposits have actually been placed at a bank and, if so, in the event of a bank failure whether deposit insurance is available to protect their money from loss. These arrangements have also increased risks that the FDIC will be unable to make prompt and accurate payment of deposit insurance in the event of a bank failure, since the FDIC can only pay deposit insurance claims if it can identify the actual consumer who owns the funds held at the bank at the time of the bank's failure.

Synapse, a technology company, was a party to deposit arrangements involving banks and financial technology companies. Synapse's bankruptcy has affected consumers' ability to access funds placed at banks for a number of months. Since May 2024, the FDIC National Center for Consumer and Depositor Assistance has received more than a thousand enquiries and complaints from consumers raising questions, concerns, or expressing frustration regarding the Synapse bankruptcy. This recent event has resulted in significant and ongoing harm to many consumers who may have believed that their funds would remain safe and accessible due to representations made regarding the placement of those funds in FDIC-insured banks.

According to public reports regarding Synapse's bankruptcy proceedings, Synapse's bank partners have encountered significant difficulties in obtaining, reviewing and reconciling consumer records. FDIC staff believes that these circumstances have raised concerns about the accuracy and integrity of those records.

At this point, I'd like to turn the presentation over to Jake Meyer, Senior Claim

Administration Analyst in the FDIC's Division of Resolutions and Receiverships, who will discuss the risks certain custodial deposit arrangements present regarding the payment of FDIC Deposit Insurance.

MR. MEYER: Thanks, Meron. The FDIC has long recognized the role of custodial accounts in the banking system and the FDIC's deposit insurance regulations accommodate these accounts through the concept of pass-through insurance.

Pass-through deposit insurance is a mechanism for recognizing the owners of deposited funds and ensuring their interests in the deposits to the same extent as if the owners had deposited the funds directly at the bank provided certain conditions are met. Generally, the FDIC makes determinations about pass-through deposit insurance coverage upon a bank's failure. For many third-party arrangements, the FDIC may in part rely on records other than those of a failed bank, including the records of a non-bank, to identify insured depositors and their insured deposits. Under the pass-through insurance regulations, such records must be maintained in good faith and in the regular course of business.

The events following Synapse's bankruptcy highlight the risks that can manifest when a bank and its third-party partners do not maintain accurate records for custodial accounts. Deficiencies in recordkeeping may impede the FDIC's ability to make a deposit insurance determination in the event of an insured bank's failure. While none of the banks that had business arrangements with Synapse have failed, the difficulties encountered by the parties obtaining, reviewing and reconciling Synapse's records against the bank's records would likely also have hindered the FDIC's ability to make a prompt and accurate deposit insurance determination in the event one of the banks had failed.

Prompt payment of deposit insurance to depositors is especially important where consumers support their day-to-day financial needs through use of deposit products accessed through a third party. The FDIC has a statutory obligation to pay deposit insurance as soon as possible following the failure of an insured bank. Typically, the FDIC provides depositors of a failed bank access to their insured deposits within a few days of the bank's failure; however, if a bank has an arrangement with a third party where custodial account recordkeeping is inadequate or unreliable, this may hinder the FDIC's ability to promptly pay deposit insurance.

In the event of a bank's failure, the FDIC must have the ability to quickly make deposit insurance determinations and pay deposit insurance to all insured depositors. This requires accurate and complete records to support the deposit insurance determination, irrespective of who maintains the records.

Because delays in paying deposit insurance could undermine confidence in the banking system more broadly, FDIC staff believes these issues are best addressed in a consistent manner across the industry through rulemaking.

At this point, I'd like to turn the presentation over to James Watts, counsel in the FDIC's Legal Division, for a summary of the proposed rule.

MR. WATTS: Thanks, Jake. New recordkeeping and internal control requirements would apply to custodial deposit accounts that are within the scope of the proposed rule. The proposal would require that for custodial deposit accounts that have transactional features, banks would maintain records of the beneficial owners of those accounts. Those records would identify who the beneficial owners are, the balance that's attributable to each owner and the ownership category in which the owner is holding the funds. The proposed rule would also provide a specific electronic file format for maintenance of those records. Next slide.

FDIC staff believes that these records would be beneficial for a couple of different purposes. First, and I think Luke touched on this earlier, these records would be important to the FDIC in the event of a bank's failure, they would enable prompt payment of deposit insurance. The records would tell us who the owners of those deposits are.

Second, even if the bank were not to fail and there was sort of a disruption that would affect the account holder, maybe something like a bankruptcy or some other operational issue, the records would establish who the owners of those funds are, enabling the bank to be able to repay customers more quickly. Next slide.

Now, as noted earlier, the proposal would create recordkeeping requirements for banks that hold custodial accounts with transactional features and that's really the heart of the proposal. It would also require banks that have these custodial accounts to maintain internal controls that include a couple of specific requirements. First, the bank's internal controls would include maintaining accurate balances of custodial accounts with transactional features at the beneficial ownership level.

Second, the internal controls would need to include conducting reconciliations against the beneficial ownership records, no less frequently than close of business daily. That reconciliation requirement is intended to address the completeness and the accuracy of transaction processing. In addition to internal control requirements, the proposal would require banks to submit an annual report and a certification of compliance. Next slide.

The proposal would apply to a class of accounts defined as custodial deposit accounts with transactional features. That term is defined as a deposit account that meets the three criteria that are on screen here. First, the account would be established for the benefit of beneficial owners. Essentially, it's another person's money, not the money of the person or the firm that has opened the account.

Second, the account holds comingled deposits of multiple beneficial owners so that comingling of funds is multiple owners who are in the account. Third, the beneficial owner can authorize or direct a transfer through the account holder from this account to a party that's other than the account holder or back to the beneficial owner themselves.

Staff believes that this definition would include, for example, the sort of omnibus custodial accounts that are used to make payments on behalf of consumers. We can move on.

Under the proposed rule, banks that hold custodial accounts with transactional features would be required to maintain records identifying the beneficial owners of those deposits. In other words, the records would identify who the owners are and how much money in the account belongs to each of them. Now, the FDIC also recognizes that banks use third parties in many cases to assist with different functions and in drafting the rule, we recognize that banks may use third parties to maintain these records as well.

I'm going to turn it over to Jake in just a moment to talk about the requirements where a bank uses a third party to maintain the records and I think we can probably get there at this point, Meron.

MS. WONDWOSEN: Yes.

MR. MEYER: Thanks, James. As noted previously, the proposal also acknowledges that many banks, including community banks, regularly employ a third party, such as vendors and technology service providers, to assist them in carrying out a variety of banking functions. As a result, the proposed rule would permit records of beneficial ownership to be maintained by the bank through a third party, such as a vendor, software provider or the account holder, if certain requirements are satisfied.

These requirements are intended to promote access to and the integrity of the necessary records. First, the bank would be required to have direct, continuous, and unrestricted access to records maintained by the third party in the format described in the proposal including access in the event of a business interruption, insolvency, or bankruptcy of the third party.

Second, the bank would be required to have continuity plans in place, including backup recordkeeping for the required beneficial ownership records and technical capabilities to ensure compliance with the proposal's requirements.

Third, records maintained by a third party could only be used to satisfy the proposal's requirements if the bank implements appropriate internal controls to accurately determine the respective beneficial ownership interests associated with custodial deposit accounts with transactional features and conduct reconciliations against the beneficial owners' records no less frequently than as of the close of business daily.

Finally, the bank would be required to have a direct contractual relationship with the third party that includes certain risk mitigation measures. I will now turn the presentation back over to Luke Brown for concluding remarks.

MR. BROWN: Thanks, Jake. Staff believes that this proposal, if and when finalized, would be a step forward in addressing the topics we've just discussed in this presentation. I do want to note that we are in the middle of the proposed rulemaking process, so we can answer most of your questions, particularly about the rule itself, the proposal itself, but we can't get into things around finalization, obviously we're still accepting public comments, and we don't know what the final rule will look like.

With that, we'd be happy to answer any questions you have of us.

MEMBER DRENTLAW: I'm curious of this, what is the definition -- is the custodial account, like, IntraFi? Like we're doing reciprocal deposits back and forth or is that -- I mean because then we're already doing this. They have a repository that tells us what banks they're coming from and we know what customers we’re reciprocating funds with, but I was curious as I was reading this if it was something like that or if it was something like Venmo, where there's a bunch of people that hold deposits there.

MR. BROWN: Yeah, that's a great question. As we are developing the rule, we are really focused on tailoring it to the risks, the issues that we've seen in the market because we have been monitoring this. The rule talks about Synapse, but we've been looking at these types of issues for years, so we identified 10 exceptions, where certain types of transactions, or I should say accounts are scoped out including, for example, an IntraFi type scenario that you're describing. That's exempted from the rule and we're accepting any comments on the exemptions if folks have opinions one way or the other on that.

MEMBER HORTON: What are examples of the type of custodial accounts then this does cover?

MR. BROWN: Sort of the way we described in the proposal presentation here, I'll break it down simply in terms of, you know, you're the consumer, you're on an app, all you know is you're on this app, you don't know what's behind it. Obviously, the way these things are structured, and they're structured in different ways, there could be a fintech company in the middle. There could be a middleware company and then ultimately that middleware company has a relationship with a bank, where deposits are made. So, when we call it a custodial account with transaction features, at the end-user point, which is the consumer point, to the extent that there are funds going in and out. They're making payments. Those are the sorts of accounts that are scoped into this proposal. Does that make sense?

MEMBER RICHARDS: So, this would not be Starbucks? Because my wife's got money at Starbucks, you know, but according to your definition, she can't pay people with her Starbucks money, she can just buy her coffee. So, that money goes to her in essence so this wouldn't apply to --

MR. BROWN: Well, I'd have to understand the Starbucks piece --

MEMBER RICHARDS: Well, you can have money with different companies to buy their --

you know, you have just money to buy their product.

MR. BROWN: Is that a prepaid card?

(Simultaneous speaking.)

MEMBER RICHARDS: Yes, so that would not be in the definition?

MR. BROWN: Well, certain prepaids are, but what you're describing, it sounds like it would not be.

(Simultaneous speaking.)

MEMBER MAUST: Yes, that's a general obligation, Starbucks.

MR. BROWN: Yeah.

MEMBER MAUST: So, it's just a customer deposit outside the banking system.

MEMBER RICHARDS: And this would not also include accounts that we have for companies that have custodial accounts, if you will, for their defined benefit plans? Where they're setting money aside, because that's not a transactional thing?

MR. BROWN: That's correct.

MEMBER RICHARDS: Okay.

(Simultaneous speaking.)

MEMBER MAUST: Think about it, the most simple example, like a neo bank, like Chime.

MEMBER RICHARDS: But there's not going to be a whole lot of these?

MEMBER MAUST: I think over time you'll start to see it and so this helps to really put a framework around how to ensure that there's clarity around the recordkeeping, not just for deposit insurance, but I think overall just to elevate the standard. Because for quite some time, financial technology companies were at the driver's seat or sort of had the wheel and dictated a lot of the recordkeeping that occurred and so I personally think this is a helpful direction.

I did have a couple of questions. One was around some of the prescriptive requirements. Were they modeled generally after Part 370 or does it go beyond typically what you find in a Part 370 institution that might have over, you know, the couple million threshold?

MR. BROWN: Well, if I can first respond to what you just said. That was an interesting comment. We have heard from supervised institutions a number of times that they're trying to do certain things, and they can't get the third party to take certain actions that they'd like to see from them. We do expect that that will be one benefit.

One thing we highlighted a little bit that is particularly unique is there's a validation provision that requires that a third party go into the third party itself. An independent entity has to go into the third party at least once a year and essentially do a validation and audit and then they've got to provide that to the bank so the bank can review that and consider whether the information being provided is accurate. I think that's an important provision focused on the third party and banks that are trying to comply supporting their efforts.

I would say this proposal is certainly informed by 370, I think we -- Jake here is from our DRR, our Division of Resolution. Others from that area have been very actively involved in this rulemaking and so we've learned a lot of lessons there and we have applied -- there's some different risks here. Of course, 370 is focused on the largest institutions. Some of these entities are not necessarily large, so there are parallels, but they're different. I don't know if anybody wants to add anything to that.

MR. WATTS: No.

MEMBER MAUST: Thank you. My second question and I can probably answer it if I dug a little deeper into the proposed rule, but I'll ask it now. If the institution controls and manages all the recordkeeping and a third party is simply accessing it or provides an interface, and I'm starting to think over time as we're using market facing and we can be contracted by the bank just in its own name, but it's filtering through that third party, but the bank is the record keeper. It is keeping it -- and I know these are custodial, so if they're individual accounts, it would probably not trigger this, it needs to be comingled?

MR. BROWN: Yes.

MEMBER MAUST: Okay, all right.

MR. BROWN: Yes.

MEMBER MAUST: That's really helpful.

MR. BROWN: There are situations where banks still maintain records and maybe they deal with a core processor that's basically an agent of theirs or there's this scenario that primarily we're talking about, so yes, is the answer.

MEMBER MAUST: Thank you.

MR. BROWN: Anyone else? Well, thank you very much.

MS. MURAYWID: Good afternoon,

everybody. Lisa introduced me, but I'll introduce myself again. My name is Sumaya Muraywid and I'm with the Division of Risk Management Supervision. I will be discussing with you today the Joint Statement on Banks' Arrangements with Third Parties to Deliver Deposit Products and Services.

I will also briefly discuss the Request for Information on Bank-Fintech Arrangements which was issued on the same day. Both of these documents were issued in July jointly by the FDIC, the OCC, and the Federal Reserve. In terms of the joint statement, the arrangements that we're discussing is when a third party directly markets or otherwise provisions a deposit product of the bank to the end user directly rather than the bank marketing and providing the provision of access to the end user itself.

The joint statement generally covers two key areas. What are some potential risks that we've observed as supervisors related to these relationships and what are examples of risk management practices that banks are using to manage those risks? Just to speak a little bit more about these types of arrangements, I mentioned the marketing piece. Often what we see is maybe one or multiple third parties that provide and perform substantial risk management and operational functions related to the deposit product. For example, one entity might perform the marketing directly to the end user, but separately, another third party may be maintaining that deposit system of record and perform the transaction processing.

In addition, one or two of these third parties may also provide the end-user application that the customer uses to access that deposit product or service and initiate payments. One or more of these third parties may also service the accounts and provide customer service. In terms of examples of potential risks related to these types of arrangements, we discuss operational and compliance risks. So, for example, to the extent significant operations related to the deposit function are performed by third parties, it may hinder or reduce some of the bank's existing controls related to their deposit function that have been developed over time by the institution.

Another potential risk is the fragmented operations. As I mentioned, one or multiple third parties may perform various parts of the deposit function and in such cases, it may be more complex for the bank to assess the risk of each of those third parties and to assess whether each third party can perform the functions that the bank has outsourced to it.

Another consideration is lack of access to records. To the extent the financial institutional can't directly access that deposit or transaction system of record, it may be more difficult for the institution to determine its deposit obligations.

Another consideration is when third parties perform various compliance functions. For example, from an AML/CFT perspective, sometimes what we've observed is that the bank relies on the third party to do suspicious activity transaction monitoring on behalf of the bank. Also, for example, customer identification program information, collection, and verification processes amongst other AML/CFT functions.

Another consideration is when the bank relies on a third party to perform compliance functions related to consumer protection. So, in those situations the bank remains responsible to its regulatory obligations regardless of whether or not it chooses to outsource those compliance functions.

Another example is a lack of contracts. I mentioned that there may be multiple third parties that perform different parts of the deposit process. To the extent that an institution has a contract with one third party, but not another third party that performs some of those critical functions, it may pose some risk to the institution.

In terms of potential risks related to growth, one consideration is any potential of misaligned incentives. For example, if a non-bank third party may have incentives to grow quickly, but the financial institution may not have that same risk appetite for growth. And in those situations, where there is substantial growth, the consideration of whether the bank's own operational functions can keep scale and grow along with that deposit growth.

Also related to growth is to the extent any of these products were to scale quickly and develop a funding concentration for the institution, that's an additional risk for the bank to consider and manage. We'll talk a little bit about some risk management considerations related to that. Of course, with growth, pressure on capital ratios. As you know, as a balance sheet grows, denominator, capital ratio may decline.

Another consideration is risks related to end-user confusion. To the extent an end user believes or is confused about whether their deposit product is insured, this confusion may really come into play when a non-bank third party could be reasonably mistaken for an insured depository institution, particularly when the third party markets FDIC deposit insurance.

Moving on to examples of risk management practices that banks may use in this space, some fundamental issues, policies and procedures, I mean particularly as banks enter into the space and develop new governance functions, it becomes critical that policies and procedures appropriately define lines of authority, reporting and other requirements. Risk assessments are also a very critical risk management component that banks may employ, particularly related to assessing whether their existing controls are sufficient to mitigate their risk system with their risk appetite.

Another powerful tool as part of risk assessment is bringing to the table all relevant functional areas and expertise areas of the bank. Due diligence is also a very important and useful tool in these types of relationships because it allows the institution to determine whether the third party or third parties have the capabilities and wherewithal to do the functions that the bank expects of them. Likewise, contracts to the extent they provide and outline clear roles and responsibilities of each party and the bank, can help the bank mitigate and control its risk.

Related to that, assessing any potential risks when the bank does not have a contract with a critical third party, as I mentioned earlier, allows the bank to consider if and how it can manage those risks. Finally, ongoing monitoring processes is an essential consideration.

In terms of managing operational and compliance implications, several factors -- I mentioned AML/CFT earlier, ensuring that those policies and procedures are updated to reflect the change in bank processes in terms of outsourcing that function. In addition, internal controls can be particularly important. As I mentioned earlier, the responsibilities change in considering whether the appropriate internal controls have carried through with those process changes and rule changes within the institution and outside the institution.

In terms of managing growth, it's an important and relevant risk management function to develop concentration limits, diversification strategies, maybe even exit strategies to allow the bank to be prepared in case the deposits were to move outside the bank. From a deposit insurance misrepresentation perspective, establishing policies and procedures including provisions related to monitoring activities of the third parties that may market the bank's deposit products and services.

With that, I'll briefly discuss the request for information; it's a separate document issued on the same day, as I mentioned. Just a couple of differences in scope between the two documents. The request for information covers a broader set of activities. While the joint statement was limited to deposits, the request for information included not only deposits, but also lending and payment activities.

Another scope difference between the two documents is the request for information is limited to bank fintech arrangements, whereas the joint statement was related to any non-bank third party and not limited to fintech. What the request for information does is it lays out our joint agency understanding of how these various arrangements are structured and also discusses the benefits and risks as we are aware of them. The request for information asks a series of questions about whether there are any additional arrangement structures that we should be aware of, any additional benefits and risks we should be aware of, as well as other specific questions.

The comment period was extended 30 days, but that extended comment period has now closed as of last week and we are working to review all of those comments and consider them. With that, I'll take any questions.

MEMBER MAUST: We did a quick analysis of the comment letters. It was interesting to see so many from financial technology companies and also to see their perspective on, and their, my take on it, lack of understanding of the banking industry and the rules surrounding that.

I'll just make this offer, I am more than happy to make myself available for any deep dive, candid, unbiased input on this. I think this is needed in the industry and having firsthand gone through it for the last five years, I'd be more than happy to provide insights to the extent it's permitted.

MR. BROWN: Thank you.

MS. MURAYWID: Thank you.

MS. ROY: All right, not seeing any other questions or comments, thank you to our panel, appreciate it. Our next item, we're going to talk about the FDIC's Final Statement Policy on Bank Merger Transactions. Joining us at the table Tom Lyons, Associate Director with the Division of Risk Management Supervision; Sheritta Holland, Senior Exam Specialist with the Division of Depositor and Consumer Protection; and, Ben Klein, Supervisory Counsel with the Legal Division.

MR. LYONS: Okay, I'm not sure if that's on. Okay, good. It's good to see everyone again. Thank you for having us back. I'm Tom Lyons in our Division of Risk Management Supervision and with me today is Ben Klein, for our Legal Division, and Sheritta Holland from our Division of Consumer Protection.

We're here to talk a little bit about the merger transactions. I know I'm a substitute on the agenda. You had George Small, but he couldn't make it today, so you have me. Hopefully that's okay.

As you know, updating the bank merger review framework has been a priority of the FDIC for quite some time. The Bank Merger Act creates a statutory framework requiring regulatory approval in connection with a variety of transactions. The FDIC has a special role within this framework as it has exclusive jurisdiction over any merger transaction involving an insured depository institution and a non-insured entity regardless of the bank's charter.

For transactions between two IDIs, the Bank Merger Act divides responsibility among the three federal banking agencies and the FDIC's jurisdiction is to act on transactions where the resulting institution would be FDIC supervised. In order to implement our responsibilities under the Bank Merger Act, the FDIC has codified regulations, issued a statement of policy and published Section 4 of our Applications Procedures Manual, known as Mergers.

On September 17, 2024, the FDIC's Board had approved for publication in the Federal Register, a final statement of policy on bank merger transactions. The final statement of policy will supersede the previous statement of policy 30 days after publication in the Federal Register. So, it was published in the Federal Register on September 27th, and it superseded the previous statement on October 28th.

The final statement incorporated and builds upon the description of the analytical considerations for each statutory factor which are individually addressed. It includes a declarative statement to highlight the FDIC Board's expectation for the evaluation of each factor. It updates, strengthens and clarifies the FDIC's policies to the evaluation of mergers. Since the existing statement was last revised in 2008, the Bank Merger Act has been amended and significant changes have occurred in the banking industry and financial system, which prompted the FDIC to update the statement.

Following the FDIC's 2022 Request for Information and Comment on Rules, Regulations, Guidance, and Statements of Policy Regarding Bank Merger Transactions, the FDIC published a proposed statement in the Federal Register on April 19, 2024. We received 23 letters in response to the proposed statement from the public including representatives of the financial services industry, trade associations, consumer groups, academics, and members of the Congress.

After reviewing the comments received, the FDIC made revisions to address those comments and so I'm going to turn it over to Ben and Sheritta who are going to walk us through some of the significant changes that were reflected in the final statement. Ben?

MR. KLEIN: Thank you very much, Tom. I can't tell if the green light is on, it's behind me.

(Laughter.)

MR. KLEIN: Good afternoon. As compared to the existing statement, the final statement is more principles based, addresses jurisdiction and scope, describes the FDIC's approach to each statutory factor separately and highlights other matters and considerations.

The final statement highlights the FDIC's expectations relative to each statutory factor and incorporates analytical considerations for these areas. Additionally, the final statement retains the proposed statement's non-exhaustive list of circumstances that could lead to an unfavorable finding on one or more statutory factors. The final statement also retains the FDIC's longstanding practice to not use conditions as a means to favorably resolve statutory factors.

The final statement indicates that the imposition of conditions will be taken into account as part of the FDIC's evaluation of the merger application but will not lead to the favorable resolution of any statutory factor where the facts and circumstances are otherwise unfavorable.

As with the proposed statement, the final statement emphasizes that the FDIC Board of Directors reserves the authority to approve or deny merger transaction for which one or more statutory factors are not favorably resolved by FDIC staff. In addition, the FDIC Board reserves authority to act on applications for which the Attorney General has not given the FDIC notification in writing that the proposed transaction would not have a significantly adverse effect on competition.

Like the proposed statement, the final

statement indicates that the FDIC Board may release a statement regarding withdrawn merger applications if such a statement is considered to be in the public interest for creating transparency for the public and future applicants. Such statements would only be issued when warranted by the circumstances and are not expected in every instance and would be in conformance with the FDIC's obligation to protect confidential information.

I'll turn it over to Sheritta.

MS. HOLLAND: Thank you, Ben. In response to comments, the final statement does not incorporate the proposed statement's assertion that the FDIC will not find favorably on the financial resource factor if the merger would result in a weaker IDI from a financial perspective. This statement was removed to avoid suggestion that an IDI that reflects a satisfactory financial condition would be precluded from absorbing a weaker institution.

It was replaced with language affirming that a favorable finding on the financial resource factor would be appropriate in cases where the resulting IDI presents less financial risk than the financial risk posed by the institutions on a standalone basis. The revised language affirms that FDIC's analysis balances the impact of the proposed merger on financial resources. This language is consistent with the FDIC's historical approach to the analysis on this factor, namely that the FDIC broadly considers the long-term financial impacts over the near-term implications of a merger.

The final statement, like the proposed statement, communicates the FDIC's expectation to hold public hearings for mergers resulting in IDIs that have 50 billion or more in total consolidated assets or where significant CRA protests are received. While the primary means of receiving public input on merger transactions is through the statutorily mandated public comment process, the final statement reflects the FDIC views that additional forums for public input for the most consequential merger transactions would be appropriate.

The final statement emphasizes that size alone is not dispositive for determining the risk to the stability of the United States banking or financial system but recognizes that transactions that result in a large IDI with total assets of 100 billion or more, are more likely to present potential stability concerns.

The final statement communicates the FDIC's expectation that additional scrutiny will be applied to evaluations of such mergers. Examples of additional scrutiny include additional information requests, more frequent discussions and correspondence with applicants and supplementary meetings and discussions with regulators and community groups. These efforts provide the FDIC with additional information and data to evaluate. As such, the timeline for these filings may be extended compared to other types of filings.

In conclusion, the final statement is a significant milestone in the FDIC's effort to update, strengthen, and clarify its approach to bank merger transactions. I want to note that the continued engagement with our fellow regulators is vitally important, especially as it relates to evaluating the competitive effects of mergers.

The FDIC coordinates with the Department of Justice when evaluating the banks' merger effects on competition. This concludes our prepared remarks, and we are happy to answer any questions you may have on the Final Statement of Policy on Bank Merger Transactions.

MEMBER RICHARDS: I had a couple comments, couple questions. I read through the document; I think overall it was very good. What I was looking for specifically was something that would address a situation that just popped up in our state and it's popping up in others and that's the credit union buy-outs of community banks, real problem.

If my numbers are right, there have been 18 announced credit union acquisitions of banks just this year, which I think is probably a record for any given year. The first ever credit union acquisition in my home state of Louisiana was announced earlier. If that goes through, we've estimated based on information from the Louisiana Tax Commission that the local governments where the banks have locations, are going to lose about 860,000 dollars a year. For the Delta region, which I'm from, that's a lot, it's a major negative impact on our communities, hospitals, law enforcement, school systems and the like.

The only mention of credit union in that document was on the very last page and it just sort of mentions credit unions are a non-bank or I can't remember how it was referred to, but there was nothing that really addressed this situation. We were talking about at lunch, and I understand that you all were limited to four statutory impacts, if you will, four categories. I just don't know why we can't, you know, we get regulators in all the time who are very creative with fitting certain situations into regulation, it seems like to me we could find a way to insert the negative financial impact on our communities through the loss of the tax revenues into one of those four impacts.

We all know why credit unions are not taxed because the Federal Credit Union Act says that they're exempt. They pay property tax, but they're exempt from bank shares tax and other taxes. We've known for a long time that there's not really any distinction any more between a credit union and a commercial bank. We've been fighting that fight for decades that they ought to be -- it looks like a duck, walks like a duck, they ought to be Donald Duck, it ought to be treated like a bank.

They are strayed away totally from their original mission and limited authorities, have become more bank-like in the products and services that they offer. Right here in D.C., Pentagon Federal Credit Union recently partnered with Goldman Sachs to finance luxury mixed-use developments with 847 million dollars in loans to develop phase two of the DC Wharf. That is not serving people of modest means at all.

Recently a Virginia-based credit union announced that it's going to pay more than seven and a half million dollars a year for the stadium naming rights to the Washington Commanders, again, right here. That credit union was started in 1947 to serve CIA employees and now they're purchasing NFL stadium naming rights and they're still tax-exempt.

I know you can only work with what you have, but for you all not to be able to consider that major impact on our communities is almost criminal. Those other impacts are important, but not nearly as important to me and the kids that go to our schools and the people in our hospitals as the loss in tax revenues. The credit union buyout poses a lot of other questions. How is the FDIC going to treat bank customers that are not supposed to be eligible for membership in a credit union? Does the FDIC conduct fair lending analysis and HMDA analysis of the acquiring credit union? Right now, they're not in CRA, so they don't have to do that. Are bank customers informed that they're going to receive less consumer protections after the credit union acquisition?

So, it just doesn't go far enough in my opinion. I would like to see, I know it's a final, but maybe you all can come up with a final, final and insert some of those things in there. Try to find a way to let that major impact be a consideration to where you all would say no, the buyout of this bank would be detrimental seriously to the viability of some of our small communities. Appreciate it.

MR. LYONS: Thank you for those comments. Appreciate it.

MS. HOLLAND: And I will say as far as the community impacts, I understand you, I understand the concerns there and I do hear that. When we evaluate the convenience and needs on the community to be served, it is a broad review and so we do look at more than just the CRA, because as you stated, credit unions are not held to the CRA, so we do take a broad review and approach to that. I understand that there are further impacts than that, you know, that are concerned there.

Thank you for your comments and I will tell you that it's being considered when we do these types of analysis, and we do look at the field of membership and the banking services and how those may change with the transition and the impact that that will have on the community and those individuals.

MEMBER RICHARDS: So, are you saying that it's potentially possible that the lost tax revenue could be a deciding factor in whether or not that application gets approved?

MS. HOLLAND: I will say that the lost tax revenue is not a part of the current consideration. We look at the impact to the community, so the individuals that are receiving the benefits, like --

MEMBER RICHARDS: That isn't it.

MS. HOLLAND: Well, it is, it is I'm not disagreeing with you there, it is. We don't currently expand to that level, but I do appreciate the comments.

MEMBER RICHARDS: Just a suggestion.

MS. HOLLAND: Thank you for that.

MEMBER DeVAUX: So, just a question, I agree a hundred percent with my friend from central Louisiana or north central Louisiana, but let me ask another question related to credit unions because if two banks are merging and then you look at the impact on the market, you don't even take into account the presence of credit unions, right?

MS. HOLLAND: Hmm.

MR. KLEIN: If two banks are merging?

MEMBER DeVAUX: If two banks are merging, you say okay, we're going to lose some market coverage from a banking perspective, but there are credit unions around, do you take that into consideration?

MR. KLEIN: They may be, yes.

MEMBER DeVAUX: Okay, I didn't see that in the report.

MR. KLEIN: Yeah, if there are competitive considerations, we will look at other market participants that could include credit unions.

MEMBER DeVAUX: Okay.

MR. KLEIN: To the extent that they provide services that are roughly equivalent to banks, if they make commercial loans and so on.

MEMBER DeVAUX: Okay.

MEMBER HORTON: Some years ago, Wheatland Bank actually sold an FDIC-insured bank branch to a credit union. I believe we were the first in the nation to do it. The FDIC was involved. I mean this was like 23 years ago and there were a lot of lawyers and regulators on all sides, and it was determined that the bank customers had to be given an opportunity to opt out because credit union insurance was not the same as FDIC insurance. So, what's happening today with these credit union bank acquisitions? Are bank customers mandatorily being communicated with that they have an ability to opt out because they're giving up FDIC insurance?

MR. KLEIN: The opt in/opt out requirement is largely a function of state law and when we're evaluating these transactions, it's really our emphasis that customers are made aware of the opt in/opt out requirements that are a function of state law and we also disclose all the differences between the insurance coverage of FDIC insurance versus NCUA insurance.

MEMBER HORTON: Because in that example, we did have customers opt out of that, so it sounds like that's evolved, perhaps more to just a disclosure? I mean there was a written opt out opportunity provided to bank customers, and it was at the federal level not the state level. At that time, it was FDIC mandated.

MS. COLOHAN: Hi, my name -- I don't know if this is on. Oh okay.

CHAIRMAN GRUENBERG: It is. Now you just turned it off. Try it again.

MS. COLOHAN: Hi, my name is Patti Colohan. I work in the Division of Risk Management Supervision, and I work with community banks and sometimes have the opportunity to review these applications. I can tell you that we do review all the disclosures that are going to go customers, similar to what you described and obviously we review them before they go out to depositors.

In those disclosures, we're looking for what the membership eligibility requirements are, that needs to be in the disclosure. Opt-in agreements, time frames for ineligible transfers or to give customers a time frame to find a new institution if they don't want to opt in with the credit union. What the account transfer process looks like and then a description of what the NCUA coverage is. So, all of the information is in the disclosures, and we review that before it goes out. Does that answer your question?

MEMBER HORTON: Great. Yes, it does. Thank you.

MS. ROY: Any other questions or comments?

MEMBER CAMPBELL: I have one question, what percentage of clients of a bank have you found to be ineligible for membership in a credit union? I mean that's expanded so much. The example I gave at lunch was I was buying a car, and they said, well, if you do a 10 dollar membership to Pennsylvania Outdoors Association, we can put you into the PSECU. What percentage?

MS. COLOHAN: So, I don't have those numbers, I don't have an exact percentage, but I would say, in general, we find by the time the application comes to us, that the vast, vast, vast majority of bank customers are eligible for the credit union, but I think in part because as a credit union is looking to buy a bank, they're looking for ones where they can take the customers. They don't go very far down the application process if it looks like the field of membership will stop them from taking most of the customers. I think those things work out as they're doing their due diligence and deciding whose branch they might want to buy.

MEMBER CAMPBELL: Yeah, I think that definition has become so broad though it's pretty much nonexistent. Okay.

MS. ROY: All right, for our final discussion of this segment, Tom is going to stay with us and he's going to cover the Notice of Proposed Rulemaking on Brokered Deposits and he'll be joined by Chantal Hernandez and Ryan McCarthy, both counsels in our Legal Division.

MR. LYONS: Thanks again. I am on the agenda for this one, so we're there for that. Tom Lyons again, Risk Management Policy, and Chantal and Ryan and I will talk with you about the proposed rule.

To start, we're going to start off with just a little bit of background, just as a refresh before discussing the proposal. So brokered deposits are covered by Section 29 of the Federal Deposit Insurance Act in Sections 337 and 303 of the FDIC's Rules and Regulations.

Section 29 states that an IDI that is not well capitalized may not obtain funds directly or indirectly by or through a deposit broker for a deposit into one or more accounts.

Section 29 defines a deposit broker as including a person engaged in the business of placing deposits or facilitating the placement of deposits of third parties with banks. There are other aspects of the definition, but this is the key aspect that comes up most often for us.

Section 29 provides for nine exclusions from the definition of a deposit broker including the primary purpose exception or PPE. Section 29 also allows the FDIC to consider and grant waivers to banks that are adequately capitalized under PCA, if the FDIC finds that acceptance of the funds by the bank would not constitute an unsafe or unsound practice.

The FDIC codified Section 29 into Section 337.6 of the FDIC's rules and regs. Section 29 does not include a definition for brokered deposits. It is defined in the rule as a deposit that is obtained directly or indirectly from or through the mediation or assistance of a deposit broker. The rule incorporates the deposit broker definition from the statute and provides additional context to help in applying the definition. Although entities can meet the deposit broker definition for other reasons, historically, the key test has been whether a third party is engaged in the business of placing or facilitating the placement of customer deposits at IDIs.

The rule also includes the statutory exceptions including the primary purpose exception. There are 14 business exceptions, two of which are the 25 percent test and the enabling transactions test. While well-capitalized IDIs can accept broker deposits without restriction, all IDIs are responsible for reporting brokered deposits accurately on their Call Reports. The IDI must perform appropriate due diligence on its specific arrangements to determine whether an entity that is involved in placing those deposits, meets the definition of a deposit broker and whether it qualifies for any exception.

The FDIC published a notice of proposed rulemaking to amend Section 337 in the Federal Register on August 23, 2024, with a 60-day comment period. We wound up extending that for an additional 30 days. The reasons why we did do that, there are several.

Many IDIs do not currently correctly apply the definitions of the rule, particularly with respect to the involvement of additional third parties within a deposit placement arrangement. A number of IDIs have misreported brokered deposits as non-brokered. All IDIs, even those that are well capitalized, do need to file Call Reports accurately, so this is something that we need to address. They are responsible for understanding the regulation and how involvements of additional third parties within a deposit placement arrangement may or may not result in the deposits being brokered depending on whether that additional third party meets the deposit broker definition.

Additionally, some deposit placement arrangements under the current rule can bypass scrutiny, potentially undermining the rules intent to allow for proper assessment and mitigation of risks associated with the brokered deposits. This could lead to deposits being categorized as non-brokered, even if the arrangement poses risks typically associated with brokered deposits.

The FDIC is proposing to make the changes and to simplify certain definitions of the 2020 final rule, to reduce operational challenges and reporting burdens. Also to help ensure uniform and consistent reporting of broker deposits by institutions and strengthen the safety and soundness of the banking system by ensuring that less-than-well-capitalized institutions are restricted from relying on brokered deposits to support risky, rapid growth. The comment period will run through November

21st.

Among the terms and changes the NPR proposes to simplify the definition of a deposit broker by replacing the matchmaking activities definition with a simpler deposit allocation services definition. Despite the FDIC's efforts in conducting outreach and providing clarifying information, the matchmaking activities definition has not been uniformly understood across the industry and has likely contributed to many IDIs not reporting sweep deposits as brokered when those deposits, from our experience, should have been brokered.

The new definition would apply to any person who proposes or determines deposit allocations at one or more IDIs. The NPR also adds to the deposit broker definition, a factor related to fees or other remuneration paid by IDIs or customers as these are indicative of whether a third party is engaged in the business of placing deposits.

It would eliminate the exclusive deposit placement arrangement exception from the deposit broker definition. Under the proposal, even if all third-party deposits went to only one bank, the third party would still be a deposit broker. The FDIC is concerned that less-than-well-capitalized institutions may seek exclusive deposit placement arrangements as the IDIs condition is deteriorating in order to avoid the limitations on brokered deposits, even though the risk the same. This change would realign the rule with our historical interpretation of the statute.

The proposal would also revise the interpretation of the primary purpose exception. It would consider the third party's intent in placing a deposit, customer funds, at a particular IDI. It would revise the notice and application procedures to no longer allow third parties to file notices or apply for or file applications for the PPE.

Some IDIs have misunderstood the PPE application approvals that have been provided to third-party applicants and have had difficulty obtaining relevant information from those third parties. Institutions are ultimately responsible, again, for understanding the arrangement so that they can file Call Reports.

The proposed rule would revise the current 25 percent test designated exception and notice process to ensure that the FDIC and the institution can properly determine whether any additional third parties meet the deposit broker definition before the exception can be invoked. It would only be available to broker-dealers or investment advisors if less than 10 percent of the total assets that they have under management for its customers, are placed into non-maturity accounts. If no additional third party, including an affiliate, is involved, then a notice would be required to meet the exception. Notices would not be immediately effective. They would require the FDIC's action before they can become effective.

If an additional third party is involved, then an application would be required. The proposed rule would also eliminate the enabling transaction test and the corresponding notice process, placing deposits into accounts with transactional features would not by itself prove that the substantial purpose of the arrangement is for a purpose other than providing deposit insurance or deposit placement services. IDIs that currently rely on an enabling transactions PPE under the notice process could file an application.

Finally, the proposed rule would clarify how and when an IDI that lost its agent institution status under the reciprocal deposits aspects of the rule might regain agent institution status as the statute and the current rule are silent on that issue. There are no other changes to the reciprocal aspect of the rule.

The last slide just has some resources for that if we get there. I don't know if, Ryan or Chantal, if you have anything you want to add.

MS. HERNANDEZ: Just wanted to note that we are in active rulemaking so we're still working on comments as they come in. As Tom mentioned, the comment period is open until November 21st and because we are discussing the rule today, we will just provide to the comment file, a memo documenting this conversation took place today at today's meeting.

MR. LYONS: Happy to take any questions.

MEMBER PLUMSTEAD: If I may, I think that the proposed rule places the risk focus in the wrong place, so in the NPR itself, the FDIC acknowledges that the risk comes from the growth in risky assets and the attempt to grow out of it. The FDIC already does a more than adequate job in controlling for the risk, whether it's credit policies or risk concentration or stress testing and brokered deposits really provide a needed tool for community banks to help with interest rate risk and to give us funding options.

And reciprocal deposits, in particular, are a crucial tool for banks like Honor to compete with bigger banks, and so in particular, I think reciprocal deposits should not be included in this new proposed rule.

I think a primary issue is the regulatory restriction on new or renewed brokered deposits for undercapitalized banks, so a practical fix might be to allow these banks to maintain existing levels of brokered deposits, but limit the renewals to a short, three-month term.

What I can see from a community bank standpoint is the potential of higher costs, increased compliance burden, and potentially placing us at a competitive disadvantage, so I agree that while the rule aims to bolster the safety and soundness of the banking system, it will again potentially put community banks on the back foot by limiting options that we have.

MR. LYONS: Thank you for that comment. As it relates to reciprocals, the only thing that we're doing in the reciprocal portion of the rule, we're not changing any of the others, is just trying to fill a gap. When an institution may lose their agent status, both the statute and the rule don't provide for how they may regain that status. So, that was one area, as it related to the reciprocals, that wasn't addressed.

MEMBER PLUMSTEAD: Okay.

MR. LYONS: Nothing else is being changed on the reciprocal side.

MEMBER PLUMSTEAD: Okay, that's helpful, thank you for the clarification.

MR. LYONS: Appreciate your comments there. We also have the waiver process for when an institution falls into adequately capitalized, they can come to us to request a waiver and we have those discussions that you're talking about, as institutions, how they address some of those situations. We take that on a case-by-case basis. But when your bank is well capitalized, there are no restrictions on brokered deposits. Just to clarify.

MS. ROY: Okay. I know we're running short on time, so I want to thank our presenters and also thank the committee for the insightful conversation today. I'm going to turn it over to Chairman Gruenberg for some brief closing comments. Chairman?

CHAIRMAN GRUENBERG: Thank you, Lisa, I promise I will be brief because we're already past our deadline here and I know some of you have travel plans.

Let me just reiterate our gratitude to the members of this committee for their willingness to serve and to share their time and expertise with us. I thought today's meeting was really terrific. The quality of the engagement in both directions, I thought, was really very good and deeply appreciate the input that you share with us. We learn a lot. I hope you learned something. I think you do as well, so I think it's a mutually beneficial relationship here. This committee has really become a part of the FDIC as an institution and something we really value, so thank you all.

Before you go, let me acknowledge one more time the members of this committee whose terms have expired and will be leaving. Troy Campbell, the President and CEO of Altoona First Savings Bank in Altoona, Pennsylvania. Michael Culhane, the President and CEO of North Cambridge Co-Operative Bank in Cambridge, Massachusetts. Susan Horton, the President and CEO and Chairman of the Board of Wheatland Bank in Spokane, Washington. Trey Maust, Executive Chairman of Lewis & Clark Bank in Oregon City, Oregon. Dom Mjartan, Vice Chair and Executive Committee Member of OPTUS Bank in Columbia, South Carolina.

April Perry, CEO and Chairman of the Board of Kentucky Farmers Bank Corporation in Ashland, Kentucky. Kim Reigelsberger, President of Preferred Bank in Rothville, Missouri. And Troy Richards, President of Guarantee Bank & Trust Company in Delhi, Louisiana.

We just wanted to put into the record for today's meeting our gratitude to all of you. Thank you very much and thanks to all of you.

Take care. Thank you.

(Whereupon the above-entitled matter went off the record at 3:09 p.m.)