Minutes

of

The Meeting of the Advisory Committee on Community Banking

of the

Federal Deposit Insurance Corporation

Held in the Board Room

Federal Deposit Insurance Corporation Building

Washington, D.C.

Open to Public Observation

November 1, 2017 – 9:11 A.M.

The meeting of the FDIC Advisory Committee on Community Banking ("CBAC" or "Committee") was called to order by Martin J. Gruenberg, Chairman of the Board of Directors of the Federal Deposit Insurance Corporation ("Corporation" or "FDIC").

The members of the Committee present at the meeting were: Richard T. Beard, President and Chief Executive Officer ("CEO"), People's Intermountain Bank, American Fork, Utah; Adriana M. Boeka, President and CEO, Americas United Bank, Glendale, California; Asif Dakri, Vice Chairman and CEO, Wallis State Bank, Houston, Texas; Christopher W. Emmons, President and CEO, Gorham Savings Bank, Gorham, Maine; David J. Hanrahan Sr., President and CEO, Capital Bank of New Jersey, Vineland, New Jersey; Jack A. Hartings, President and CEO, The Peoples Bank Co., Coldwater, Ohio; Chandler J. Howard, President and CEO, Liberty Bank, Middletown, Connecticut; Danny J. Kelly, President and CEO, The Hometown Bank of Alabama, Oneonta, Alabama; Arvind A. Menon, President and CEO, Meadows Bank, Las Vegas, Nevada; Mary Ann Scully, Chairman, President, and CEO, Howard Bank, Ellicott City, Maryland; John M. Tolomer, President and CEO, The Westchester Bank, Yonkers, New York; and Joseph W. Turner, President and CEO, Great Southern Bank, Springfield, Missouri.

Tiffany Baer Paine, President and CEO, Security Bank USA, Bemidji, Minnesota, and Gwen M. Thompson, President and CEO, Clover Community Bank, Clover, South Carolina, were absent from the meeting.

Corporation staff who attended the meeting included: Ryan Billingsley, Rebecca Bittle, Luke H. Brown, Richard A. Brown, Kitty Chaney, Karyen Chu, Suzanne L. Clair, Kymberly A. Copa, Christine M. Davis, Stephanie Downing, Doreen R. Eberley, Diane Ellis, Shannon N. Greco, Marianne Hatheway, Todd L. Hendrickson, Stefan Jacewitz, Nicholas Kazmerski, Matthew Kepniss, Vivek Khare, Yan Y. Lee, Rae-Ann Miller, Patrick Mitchell, Emmanuel Monteau, Benjamin L. Navarro, Shayna Olesiuk, Mark E. Pearce, Lavonne R. Pherson, Sylvia H. Plunkett, Claude A. Rollin, Barbara A. Ryan, Robert F. Storch, Maggie M. Thompson, Howard G. Whyte, and Smith T. Williams.

Chairman Gruenberg opened and presided at the meeting. He began by sharing his support and sympathy for all those affected by Hurricanes Harvey, Irma, and Maria. He observed that Texas, Florida, Puerto Rico, and the Virgin Islands had been particularly hard-hit by these recent natural disasters. The first item on the agenda would therefore be a report describing the FDIC's efforts in impacted areas. Chairman Gruenberg advised that the second panel of the morning session would outline preliminary results drawn from the FDIC's survey regarding small business lending by community banks. He indicated that the survey was the first of its kind and was designed to provide greater understanding with respect to the critical niche community banks fill in financial markets. Next, Chairman Gruenberg acknowledged the Committee's support for FDIC efforts to encourage the establishment of new institutions. He noted that the final panel of the morning session would provide an update regarding de novo bank applications. Turning to the afternoon session, Chairman Gruenberg advised that the first panel would discuss FDIC efforts to reduce regulatory burden pursuant to the interagency process prescribed by the Economic Growth and Regulatory Paperwork Reduction Act of 1996 ("EGRPRA"). Efforts to reduce burden encompassed a range of issues, he noted, and had been the subject of discussion at outreach meetings held throughout the country. In a similar vein, the final panel would outline supervisory issues of particular interest to community banks. Chairman Gruenberg then introduced Barbara Ryan, Deputy to the Chairman and Chief Operating Officer/Chief of Staff, who moderated the rest of the day's proceedings.

Ms. Ryan introduced the presenters of the first panel, "Resilience of Banks in the Face of Hurricanes and Other Natural Disasters," as Doreen R. Eberley, Director, Division of Risk Management Supervision ("RMS"); Rae-Ann Miller, Associate Director, RMS; and Shayna Olesiuk, Associate Director, Division of Insurance and Research ("DIR"). She framed the discussion by noting that Ms. Eberley would outline specific steps the FDIC takes in partnership with banks to prepare for an impending natural disaster; Ms. Miller would focus on overall policies and guidelines issued by the FDIC; and Ms. Olesiuk would describe the broader impact of natural disasters on the economy.

Ms. Eberley emphasized that, when dealing with natural disasters, communication and preparation are essential. In fact, preparations at the FDIC typically begin five days prior to landfall thanks to projections issued by the National Hurricane Center and mapping software managed by DIR. Agency principals such as the FDIC Chairman and his counterparts at other agencies are briefed, banks in the projected path of the storm are identified, post-storm call schedules are issued, and technology service providers are contacted in order to discuss contingency plan implementation and moves to backup sites. With respect to post-storm calls, Ms. Eberley explained that they are made for the purpose of assessing the operating status of each bank in the storm's path, identifying any needs the banks might have, and initiating action to address those needs. Ms. Eberley observed that, after a storm, banking staff are naturally absorbed with the safety of their families and neighbors. The FDIC therefore pauses before rolling-out post-storm calls and generally initiates calls no sooner than one day after each storm has passed. Ms. Eberley then recounted some of the actions the FDIC took in response to requests received from banks during the post-storm calls. These included working with the Federal Reserve Banks to address cash needs, identifying areas requiring additional fuel, helping banks access the government emergency telecommunications system, and facilitating communication with technology service providers.

Ms. Eberley reported that even though there were over 1,500 financial institutions in the paths of Hurricanes Harvey, Irma, and Maria, all but nine of the 1,500 institutions had at least one branch or operations center open within a day of landfall. Those institutions that took a little longer to open were located in areas that were hardest hit, with power and telecommunications rendered inoperable. But even they opened within a few business days and were serving customers, though perhaps on a part-time schedule. Ms. Eberley recalled that the FDIC and other members of the Federal Financial Institutions Examination Council ("FFIEC") had issued an "Appendix J" to the "FFIEC Business Continuity Planning Booklet" in 2015 as a result of lessons learned from Hurricane Sandy in 2012. She suggested that those refinements to the Continuity Planning Booklet, together with the extensive efforts made by banks to proactively prepare for natural disasters, had contributed to strong performances by community banks, even in the face of natural disasters as momentous as Hurricanes Harvey, Irma, and Maria. She advised that the FFIEC would review lessons learned from the three recent hurricanes, together with the suggestions of the Committee members, and update the Continuity Planning Booklet as necessary.

Next, Ms. Miller described the wealth of information available to banks and consumers through the FDIC's dedicated webpage titled "Natural Disaster Impact on Banking Operations." For example, consumers are encouraged to incorporate financial preparedness—periodically reviewing insurance coverage, building an emergency savings fund, signing up for direct deposit, organizing important documentation, utilizing digital storage and safety deposit boxes—into their disaster plans. Other guides walk consumers through the post-disaster process of working with insurance companies, adjusters, contractors, and creditors; handling settlement payments; and protecting themselves from fraud and scams.

With respect to banks, Ms. Miller noted, resources range from Financial Institution Letters ("FILs") announcing regulatory relief for financial institutions located in areas impacted by specific storms, to wide-ranging studies such as "Lessons Learned from Hurricane Katrina: Preparing Your Institution for a Catastrophic Event." That paper lists the problems Hurricane Katrina caused for institutions, such as communication outages which made it difficult to locate key personnel; lack of reliable transportation, electrical power, or fuel; destroyed or damaged facilities; underwater ATMs; and interrupted mail service. The paper describes steps banks can take to mitigate such problems, including designing and practicing disaster drills, developing communication strategies, identifying alternative meeting places, locating backup facilities, and encouraging staff to develop personal plans to assure their well-being and protect their families.

Returning to initiatives linked to specific storms, Ms. Miller referred to recent FILs providing guidance to help financial institutions facilitate recovery in areas impacted by recent hurricanes. For example, FIL-46-2017 (Hurricane Maria), FIL-43-2017 (Hurricane Irma), and FIL-38-2017 (Hurricane Harvey) encouraged banks to work constructively with customers experiencing difficulties beyond their control because of damage caused by the hurricanes. The FDIC suggested, when consistent with safe-and-sound banking practices, that banks might consider waiving fees, increasing ATM cash limits, easing credit card limits, allowing loan customers to defer or skip payments, delaying the submission of delinquency notices to credit bureaus, extending repayment terms, restructuring existing loans, easing terms for new loans, or using non-documentary verification methods permitted by the Customer Identification Program requirement of the Bank Secrecy Act. The FDIC also announced that banks might receive favorable Community Reinvestment Act consideration for community development loans, investments, or services in support of disaster recovery. Ms. Miller pointed out that the FILs also discussed obtaining relief from certain filing and publishing requirements. For example, a bank encountering problems filing Consolidated Reports of Condition and Income ("Call Reports") is encouraged to alert its primary regulator and might be eligible for penalty-waivers in some circumstances. Likewise, a bank wishing to establish temporary facilities could ask its regulator for expedited processing.

Ms. Miller concluded her overview of FDIC policies by referring to the press release titled, "Temporary Exceptions to Appraisal Requirements in Areas Affected by Severe Storms and Flooding Related to Hurricanes Harvey, Irma, and Maria," available in the meeting materials. (FDIC-PR-81-2017 dated October 17, 2017). Ms. Miller explained that the federal financial institution regulatory agencies temporarily eased appraisal requirements for real estate-related financial transactions in areas declared to be a major disaster. More specifically, the agencies will not require financial institutions to obtain appraisals for affected transactions if the properties involved are located in areas declared major disasters, if there are binding commitments to fund the transactions within 36 months of the date the areas were declared major disasters, and if the value of the real properties support the institutions' decisions to enter into the transactions.

Next, Ms. Olesiuk outlined the FDIC's approach to researching and analyzing the economic impact of storms. Ms. Olesiuk began her presentation by directing the Committee's attention to the Winter 2005 edition of the publication "FDIC Outlook," available in the meeting materials. That edition provided several analyses of the economic impact of Hurricane Katrina and serves as a benchmark for understanding the current experience. Ms. Olesiuk advised that FDIC economists and financial analysts are in the early process of assessing the impact of Hurricanes Harvey, Irma, and Maria. As a preliminary matter, however, we know the hurricanes impacted output and employment, with a drop in output and employment immediately after the storm, followed by a stronger performance as recovery begins. Likewise, the storms were a drag on third quarter gross domestic product ("GDP") but forecasts for the full year of 2017 remain unchanged from expectations prior to the storms, meaning little change overall. With respect to regional differences, Ms. Olesiuk commented that real estate losses are an important component of the overall economic impact of the storms and are still in flux. As an initial matter, however, we know that the impact in Florida appears greater than in Texas based upon the number of claims already filed. An additional layer of complexity, however, is that much of the damage in Florida was wind-related, which is typically covered by insurance, while the damage in Houston was flood-related, which is not typically covered by homeowners insurance. Ms. Olesiuk then shared the FDIC's preliminary findings regarding the impact of the storms on the tourism, agriculture, and energy sectors. Overall, the three hurricanes are estimated to have caused damages of about $222 billion in total economic losses. On a more positive note, Ms. Olesiuk noted that the banks headquartered in the areas designated as disaster areas were in strong condition before the storms hit. More specifically, they had strong capital levels, strong earnings, and strong asset quality. Ms. Olesiuk noted that the banks therefore appear well-positioned to withstand the economic impact of the storms.

Ms. Olesiuk then addressed Member Howard's question regarding whether any of the data included information concerning Puerto Rico's recovery. Member Tolomer observed, when the regulatory agencies grant exceptions, that can be helpful for communities and institutions trying to help one-another get life back to normal as quickly as possible. Ms. Eberley addressed Member Hartings's questions regarding bank relocations and reopenings. Ms. Miller then addressed Member Boeka's questions regarding recent California fires and recovery. At Chairman Gruenberg's invitation, Member Dakri then recounted the recovery efforts he observed during a recent trip to Houston, Texas.

Ms. Ryan announced that the meeting would briefly recess. Accordingly, at 9:56 a.m. the meeting stood in recess.

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The meeting reconvened at 10:15 a.m. that same day, with Ms. Ryan introducing the panel for the Committee's next presentation, "Small Business Lending Survey," as Diane Ellis, Director, DIR; Smith Williams, Chief, Consumer Research Section, DIR; Yan Lee, Economist, DIR; and Karyen Chu, Chief, Consumer Research and Examination, DCP. Ms. Ryan advised that the panel would outline preliminary results from the FDIC's recently completed Small Business Lending Survey ("SBLS" or "Survey").

Ms. Ellis recalled that she and members of her staff announced the launch of the SBLS, and solicited the Committee's input with respect to the scope of the Survey, at the April 2016 CBAC meeting. Small businesses are an important component of the US economy and rely on bank financing, yet small business lending by banks was understudied due to a lack of data, she noted. The FDIC therefore launched the Survey in an effort to gain insight into aspects of small business lending. As Chairman Gruenberg noted earlier, the Survey is the only nationally representative survey of banks and small business lending. Ms. Ellis stated that the FDIC partnered with the US Census Bureau to gather the data and that the full report will be released in 2018. In the meantime, however, the FDIC wished to share preliminary findings with the Committee and solicit their feedback.

Ms. Williams emphasized that data gathered through the Survey was particularly important because of the lack of data exploring bank lending to small businesses; the few surveys that did exist were limited to particular banks or states or had low participation rates. In contrast, the FDIC Survey had a high response rate, gathered nationally representative data, and explored a range of topics. The topics included the characteristics of small business borrowers, market area and competitors, perceived competitive advantages, loan products and underwriting, relational business lending, and small businesses commercial and industrial ("C&I") lending. Ms. Williams paused to observe that the community banks had been especially helpful in developing and clarifying the questions used in the Survey. She singled out Committee Member Scully for providing particularly valuable assistance during the cognitive testing phase.

The panelists then discussed the practice of using Call Report data as a proxy. Ms. Chu explained that reliance on such data resulted in an understatement of the amount of small business lending by small banks. The SBLS enabled the FDIC to collect more robust data regarding C&I lending and, using that data as a starting point, the FDIC can demonstrate that small business lending by small banks is understated and, further, extrapolate those findings to the full population of small banks. Overall, the Call Report proxy (1) does not count C&I loans collateralized by one-to-four family residences; (2) understates C&I lending to small businesses by not counting C&I originated for loan amounts greater than one million dollars; and (3) with respect to banks with less than a billion dollars in assets, and using a conservative interpretation, staff extrapolates that a substantial dollar amount of C&I loans were actually to small businesses. After discussing each of these three findings in detail, Ms. Chu noted that staff extrapolates that small business C&I lending by small banks was understated by at least $38 billion using the Call Report proxy from the 2015 fourth quarter Call Report data. In turn, $38 billion is approximately one-third of the $118 billion C&I component of the Call Report proxy. This suggests to staff that the C&I component was understated by approximately one-quarter.

Next, Ms. Lee discussed the nature of small business lending by small banks as revealed through preliminary results from the Survey. She explained that small banks offer loan products for various purposes, focus on traditional underwriting and owner and business characteristics, and are willing to lend to start-ups. In addition, small banks interact locally and are "high touch," relying on staff-intensive, interpersonal engagement. Ms. Lee also described the factors that make small banks special, as shown by the Survey. These factors include the perception that small banks are seen as relational, attentive, fast, and flexible. This sets them apart from big banks and other competitors, Ms. Lee noted, with the result that even large banks see small banks as competitors in the small business lending space. In fact, small banks can customize, Ms. Lee observed, which gives them a distinct advantage over large banks. After further discussing the preliminary results of the SBLS, Ms. Lee concluded her remarks by noting that more details and additional findings will be forthcoming in the public report when it is issued in 2018.

Following the panelists' presentations, the Committee members and staff discussed the Survey at length. After seeking clarification with respect to the definitions used in the Survey, as contrasted by the definitions used for purposes of Community Reinvestment Act ("CRA") examinations, Member Boeka noted that the Survey reflected her experience in the Los Angeles market. Member Tolomer concurred that the preliminary findings were consistent with his experience in the New York Metropolitan banking sector. He suggested, however, that staff revisit the definition of "small business" to ensure that the numbers were current, noting that even medium-sized businesses with 20 to 50 million dollars in sales typically want to speak to someone individually; in other words, medium-sized businesses also seek the relational, hands-on banking that small banks offer. Member Hanrahan referred to the underwriting criteria commonly used by small banks as identified in the Survey, and agreed that flexibility with customers is the stock-and-trade of small banks. Member Scully applauded staff for uncovering the under-reporting of small banks' activity and raised with staff the option of revising Call

Reports to more precisely capture all the lending that is occurring. In response to questions posed by Member Beard regarding competition based upon interest rates, Ms. Lee responded that it appears to be a spectrum but that more detailed results would be included in the final report. Member Dakri then followed-up with concerns regarding small business lending from a commercial real estate lending standpoint. Member Emmons asked staff to expand upon regional variances in the data. He also asked if the Survey delved into the impact of Small Business Administration ("SBA") guaranty programs. Ms. Chu responded that staff is just beginning to analyze the regional data but plan to include that data in the final report. As to SBA loans, however, Ms. Lee indicated that the thrust of the Survey was to ask the banks to tell us about their programs; the FDIC knows whether a bank is an SBA lender, however, and can determine whether there are differences in how such banks answered the Survey questions, if such information would be helpful.

Three of the members referred to an initiative by the Consumer Financial Protection Bureau ("CFPB") seeking information about the small business lending market, pursuant to section 1071 of the Dodd-Frank Wall Street Reform and Consumer Protection Act. Under section 1071, the CFPB is required to collect data about small business lending to help identify needs and opportunities in the market and to facilitate enforcement of fair lending laws. While supportive of the overall goals, the members cautioned that regulators must be thoughtful in their approach. The members advise that lenders do want to risk even a hint of criticism from the regulators and so the financial sector could become more rigid in their lending practices if data-capture efforts are restrictive; they urged regulators to preserve some level of flexibility.

Overall, the members agreed that the preliminary results of the Survey echoed their own banking experience and applauded the FDIC for conceiving and executing this essential investigation into small business lending.

Ms. Ryan then introduced the next agenda topic, "Update on De Novo Applications," presented by Doreen Eberley, Director, RMS. Ms. Eberley advised that the FDIC has approved 11 applications since 2011 (the post-crisis period), with eight applications having been approved in the last 12 months. In addition, five applications are under review. She then reviewed the wealth of materials available to those interested in the application process. For example, the FDIC's website aggregates information regarding past and current applications, including links to past decisions as well as pending applications open for comment, and links to guides such as the Organizer's Handbook. Aside from these guides, FDIC regional staff also engage in pre-filing discussions with organizing groups with the goal of assuring the organizers are well prepared to complete the application process successfully. She acknowledged that organized groups are incurring costs as they lay a foundation for opening an institution, and assured the Committee that staff works as quickly as they can to complete their analyses of an application without sacrificing the quality of the review. Overall, the hallmarks of a successful application include a comprehensive business plan, a management plan that identifies key directors/officers with requisite experience in the proposed markets and business lines, and a capital plan that provides sufficient capital relative to the risk profile and growth plans of the institution.

The Committee members and staff then discussed a range of issues touching upon the application process, including the qualifications of potential board members; regional differences in the rate of applications, with most activity concentrated on the West Coast; and the rate of failure among de novos. Ms. Eberley invited Member Tolomer to share his experience with respect to establishing and managing a new bank. Member Tolomer stressed that the directors of a new bank must believe in the bank's business plan because there is constant pressure from others to deviate from the business plan and try something new. While modifications are sometimes necessary, significant revisions must be approached carefully. Member Howard concurred that banks must have solid strategic plans and pointed out it takes discipline to follow the plan.

With respect to the rate of applications, Member Boeka noted that there had been a larger volume of applications in the early 2000s. She asked if there was a reason for the current, lower numbers. Ms. Eberley indicated that changes in the law—such as the elimination of interstate branching restrictions, the elimination of intrastate branching restrictions at the state-level, as well as voluntary consolidations—created opportunities for new growth during the early 2000s.

Chairman Gruenberg pointed out that the Survey previously discussed suggested that 11 percent of small banks accept small business loans applications online over the bank's website. The Chairman asked the members whether that percentage seemed accurate. The consensus of the members was that the figure appeared high. The members responded that some institutions make forms available online to facilitate the application process. However, small business loans are typically made only after having a face-to-face discussion with the customer. The members then raised the topic of niche "fintech" firms and asked, if such a firm applied for deposit insurance, how the FDIC would approach the application. In response, FDIC staff outlined some of the factors that are necessarily analyzed in any application, including financial history, funding structure, management expertise, business model, convenience and needs of the community to be served, and consistency of corporate powers with applicable rules and regulations.

Ms. Ryan announced that the meeting would recess for lunch. Accordingly, at 11:50 a.m., the meeting stood in recess.

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The meeting reconvened at 1:09 p.m. that same day, at which time Ms. Ryan introduced the fourth panel, "EGRPRA Implementation Update," and its presenters Ryan Billingsley, Corporate Expert, RMS; Luke H. Brown, Associate Director, DCP; Rae-Ann Miller, Associate Director, RMS; Robert Storch, Chief Accountant, RMS; and Vivek Khare, Counsel, Legal Division.

Mr. Khare led the discussion. He first provided an overview of the EGRPRA process, reminding the Committee that the banking agencies submitted the joint EGRPRA report to Congress on March 21, 2017. He explained that EGRPRA requires federal banking agencies, along with the FFIEC, to conduct a review of the rules at least once every ten years to identify any outdated or unnecessary regulations; consistent with EGRPRA requirements, the agencies grouped regulations into 12 regulatory categories and sought comment through four Federal Register notices, each addressing three categories of rules and each providing a 90-day comment period; the agencies also held six public outreach meetings so interested parties could present their views directly to agency principals and senior management. Mr. Khare noted that a number of the Committee members served as panelists at those sessions and thanked them for their participation at the outreach events. Of particular interest to the Committee, the current EGRPRA review focused on the effect of regulations on smaller institutions such as community banks and savings associations. Altogether, the Agencies received more than 250 comment letters during the review process plus numerous written and oral comments during the outreach sessions.

Mr. Khare advised that the panelists would next provide an update on a few key initiatives underway as part of the EGRPRA process, including reviews of Call Reports, appraisal requirements, capital requirements, flood insurance, and exam modernization.

Mr. Storch summarized recent and ongoing initiatives to reduce the burden associated with Call Report requirements for community banks. Details regarding these efforts can be found in the meeting packet materials, including the FFIEC press release dated June 20, 2017, titled "FFIEC Proposes Additional Revisions to Streamline Call Report for Small Institutions," and FDIC FIL-24-2017, dated June 27, 2017, titled "Proposed Revisions to the Consolidated Reports of Condition and Income (Call Report)."

Mr. Storch recalled that he outlined earlier burden-reduction efforts at the July 12, 2017, CBAC meeting and reminded the Committee that the new streamlined FFIEC 051 Call Report (banks with domestic offices only and total assets less than $1 billion) was implemented in March 2017. Mr. Storch reported that approximately 70 percent of the eligible small institutions opted to use the report as of the June 30th report date.

The second-phase burden reduction proposal, which applied to the FFIEC 051, as well as the FFIEC 031 (banks with domestic and foreign offices) and the FFIEC 041 (banks with domestic offices only), was published June 27, 2017. 82 Fed. Reg. 29147 (June 27, 2017). That proposal outlined additional revisions, including changes to the definition of "past due" and changes in the accounting for equity investments. The comment period ended August 28, 2017. Comments are under review. Subject to senior management approval, the FFIEC and the agencies plan to finalize the proposed Call Report revisions and communicate the changes to all reporting institutions before year-end 2017.

Mr. Storch observed that the statute that requires the federal banking agencies to fully review Call Report data items every five years, which is separate and apart from EGRPRA but coincided with the EGRPRA timeline this period, directs the agencies to reduce or eliminate the collection of data items that the agencies determine are no longer necessary or appropriate after the completion of the review. That mandate led to the burden-reduction initiatives included in the June 27, 2017, proposal as well as the earlier proposal leading to the creation of the FFIEC 051. A key element of the burden-reduction initiatives is a series of nine surveys of internal users of Call Report data within the FFIEC member entities. Each survey covers a group of Call Report schedules. Mr. Storch advised that the surveys were conducted over an 18-month period in 2015-2017. The feedback from those surveys, along with input from banker outreach activities, resulted in the development of a series of burden-reduction proposals. The third-phase proposals will be issued shortly for a 60-day comment period.

Mr. Storch then turned to efforts to explore alternatives to the $1 billion dollar asset-size threshold that generally determines eligibility for the new FFIEC 051 Call Report. An interagency working group has made good progress in developing options for expanding eligibility, he reported. With respect to the FFIEC 041, Mr. Storch indicated the agencies are reviewing the data items reported in that form that are currently applicable only to institutions with $1 billion dollars or more in total assets, and considering how these data items should be handled if eligibility to file the FFIEC 051 report is expanded to include certain institutions with $1 billion dollars or more in total assets. The agencies anticipate deciding on an eligibility expansion option that they would recommend to the FFIEC within a few months. If approved, the FFIEC 051 eligibility criteria for institutions with domestic offices only and $1 billion dollars or more in total assets would be proposed for industry comment in 2018.

Mr. Storch closed his presentation by noting that revisions to the regulatory capital rules would likely impact the reporting of regulatory capital data in the Call Report.

Ms. Miller opened her comments by noting that the agencies received a number of comments in the EGRPRA process regarding the monetary thresholds prescribed in the interagency appraisal regulations. She reminded the members that the current thresholds prescribed in the regulations are $250,000 for commercial real estate and residential transactions, and $1 million for business loans where the source of repayment is not rental income or sale of the property (commonly referred to as owner-occupied properties). Some commenters said the thresholds should be raised; others felt the thresholds provided important protections and should stand; some commenters reported a scarcity of appraisers in rural areas and claimed transactions were delayed due to lack of appraisers. The FDIC also discovered that some stakeholders misinterpreted the thresholds with the result that some thought the regulations required appraisals even for transactions that fell below the thresholds.

The agencies addressed these concerns in the EGRPRA report to Congress. They outlined three steps to address these issues. First, the agencies issued a proposal to increase the threshold level at or below which appraisals would not be required for commercial real estate transactions from $250,000 to $400,000. 82 Fed. Reg. 35478 (July 31, 2017). The comment period closed on September 29th. The agencies are reviewing comments received and plan to forward a final recommendation to their principals in the near future. Second, the agencies issued advisory guidance in March 2016, reminding the industry that appraisals within the dollar thresholds do not require appraisals under the agency regulations. Third, the agencies issued guidance in an effort to draw attention to existing options that could help mitigate problems stemming from appraiser shortages.

Moreover, in an effort to gain a deeper understanding of the issue of scarcity in general, Ms. Miller reported that the agencies have scheduled six meetings to date with banking commissioners and local institutions in rural states. Sessions concluded to date included meetings in Michigan and Tennessee. Future meetings will be held in Wyoming, North Dakota, South Dakota, and Montana. Based upon the two initial meetings, concerns seem to center on appraisers for commercial rather than residential properties, the challenge of finding qualified appraisers, and deciding when or if appraisals are required for rollovers and renewals of existing credits. Ms. Miller closed her remarks by advising that bankers at outreach meetings to date agreed that raising the thresholds for commercial property also helped mitigate the scarcity issue due to the small size of many of their transactions.

Mr. Billingsley discussed interagency proposals to simplify the regulatory capital rules for community banks and savings associations. First, the agencies published a notice of proposed rulemaking ("NPR") titled, "Regulatory Capital Rules: Retention of Certain Existing Transition Provisions for Banking Organizations That Are Not Subject to the Advanced Approaches Capital Rules," 82 Fed. Reg. 40495 (Aug. 25, 2017). That NPR would extend the current treatment under the regulatory capital rules for certain deductions and risk weights and certain minority interest requirements, as they apply to banking organizations that are not subject to the advanced approaches capital rules (the "nonadvanced approaches banking organizations"). Mr. Billingsley explained that, for example, these would include mortgage servicing assets, certain deferred tax assets, investments in the capital of unconsolidated financial institutions, and minority interests. If approved as a final rule, the NPR would pause the fully phased-in transition scheduled to kick-in January 1, 2018.

Second, the agencies issued an NPR on a proposal to simplify the regulatory capital treatment of those items. He explained that providing the proposed extension to non-advanced approaches banking organizations for those items would avoid potential burden on banking organizations that may be subject in the near future to a different regulatory capital treatment for these very items. That NPR titled, "Simplifications to the Capital Rule Pursuant to the Economic Growth and Regulatory Paperwork Reduction Act of 1996," 82 Fed. Reg. 49984 (Oct. 27, 2017), specifically deals with items discussed in the EGRPRA Report. Mr. Billingsley explained that the agencies proposed a number of modifications to the capital rule aimed at reducing regulatory burden.

He then discussed, in turn, the significant provisions proposed in the NPR. First, the agencies propose to replace the existing "high volatility commercial real estate" ("HVCRE") exposure category as applied in the standardized approach with a newly defined exposure category called "high volatility acquisition, development or construction ("HVADC") exposure. The proposed HVADC exposure definition is intended to be substantially simpler for banks to implement. He emphasized that the new HVADC definition includes a definition of what is called a "permanent loan." A permanent loan would be a loan that has a clearly identified, ongoing source of repayment sufficient to service amortizing principals and interest payments aside from the sale of the property. Thus, for example, that could include an acquisition, development, or construction ("ADC") loan to a borrower where it is owner-occupied construction and the borrower has sufficient operating income to service the loan, and the sale of the property is not the primary source of repayment. That loan, Mr. Billingsley stated, would not be HVADC under the proposed rule. After further describing key differences between the current definition and the proposed revision, Mr. Billingsley addressed bankers' concerns that they might have to reevaluate their existing loan portfolio. He assured the Committee that, in order to mitigate any burden associated with having to reevaluate a bank's portfolio against the new HVADC definition, the NPR included a grand-fathering provision. As a result, a bank could maintain its existing ADC exposures risk weight; only newly originated ADC loans after the effective date of the final rule would be measured against the new definitions.

Returning to the other significant provisions proposed in the NPR, he indicated the second significant proposal by the agencies was to simplify the current regulatory capital treatment of "mortgage servicing assets" ("MSAs"), certain deferred tax assets" ("DTAs"), and investments in the capital of unconsolidated financial institutions for non-advanced approaches banking organizations. Third, the agencies propose a significantly simpler methodology for non-advanced approaches banking organizations to calculate minority interest limitations.

Mr. Billingsley concluded his remarks by outlining some of the resources the agencies were providing to help adapt to the rule. First, the agencies published a summary of the proposal for community banks, included in the Committee materials. Second, the FDIC posted on its website an Excel-based estimation tool. This tool enables banks to plug-in numbers in order to more easily estimate the impact of the proposal on the institution. Third, the agencies conducted a national webinar to discuss the NPR and address questions, and that webinar is available on the FDIC website.

Members Hanrahan and Turner commented that the proposed HVADC is an improvement over HVCRE but advised that their banks would submit comment letters in response to the NPR, and asked staff to clarify what would qualify as a clearly documented payment source.

Next, Mr. Brown reported that several commenters in the EGRPRA process asked the agencies to provide more guidance with respect to flood insurance requirements. The agencies agreed that additional guidance would be helpful. The traditional vehicle for transmitting flood insurance guidance is the "Interagency Questions and Answers Regarding Flood Insurance" ("Q&As") publication, and the agencies are therefore engaged in the process of updating the Q&As. Issues under review include force-placed insurance, flood insurance requirements for detached structures, and flood insurance escrow requirements. Referring to the Committee's earlier discussion of natural disasters, Mr. Brown advised that the agencies are considering whether the current guidance should be revised to incorporate a natural-disaster perspective. He noted that many questions regarding flood insurance can be quite technical and the agencies were therefore collecting a broad range of questions and answers in an effort to provide a comprehensive response. Currently, the goal is to issue updated guidance in mid-2018. Following past practice, the agencies will issue the revised Q&As for public comment prior to final issuance.

Member Howard suggested there was some confusion regarding force-placed insurance and the underlying disclosure requirements. He asked if there was specific language that reached the appropriate level of disclosure. Mr. Brown responded that the agencies had, indeed, received a range of questions concerning the notice requirement, that the agencies were receiving helpful feedback, and were studying the issue carefully. In response to a question from Member Boeka regarding flood insurance requirements in areas that are not flood zones, Mr. Brown advised that existing Q&As discussed the extent of a flood area but agreed that it would be helpful to revisit, in view of the recent natural disasters, to determine if more specific or expanded guidance would be helpful. He noted, however, that from a safety-and-soundness perspective, banks have the discretion to require borrowers to have flood insurance even in locations outside flood hazard areas.

Next, Ms. Miller discussed efforts to modernize the bank examination process. She indicated that the agencies acknowledged through the EGRPRA report that bankers were not only focused on regulatory burden but also the potential burden of supervisory practices. The FFIEC therefore formed a group to review the effectiveness, efficiency, and quality of the safety and soundness examination processes for community banks with a particular emphasis on leveraging technology. The project is envisioned as long term and multi-phased and is focused on (1) reviewing examination practices and processes, (2) reviewing the format of the examination report itself, and (3) reviewing the Uniform Bank Performance Report and related reports and data to determine if there are ways to make those products more informative, useful, and user-friendly.

By way of background, Ms. Miller noted that the examination process had evolved from a “one-size-fits-all” approach to a risk-based approach; outlined the multiple factors that go into designing a risk-based exam; observed that the FDIC’s approach is consistent with other banking agencies; and described current efforts to obtain input from stakeholders. She acknowledged the insights previously provided by the Committee members and described the broad range of out-reach calls and meetings staff has held to date.

Overall, the majority of bankers agree with the Committee that it is helpful to have onsite access to examiners during the exam process itself. The bankers reported that it helped to discuss best practices with examiners since the examiners visit multiple banks. The bankers also believed that some tasks cannot or should not be done off site. That being said, Ms. Miller reported, bankers and examiners believe that more tasks could be completed offsite though one of the primary barriers to moving more tasks offsite was assuring the security of the data. After further summarizing banker and examiner feedback, Ms. Miller advised that the next step in the project is to formulate recommendations for the agency principals to consider.

The final panel for the day, “Supervision Policy Issues,” was presented by Doreen Eberley, Director, RMS; Mark Pearce, Director, DCP; Luke H. Brown, Associate Director, DCP; Rae-Ann Miller, Associate Director, RMS; and Robert Storch, Chief Accountant, RMS.

Mr. Brown discussed recent developments involving the Home Mortgage Disclosure Act (“HMDA”). After summarizing the CFPB’s activities with respect to HMDA, he reported that the CFPB rule exempts from reporting altogether institutions that make relatively few loans. This exemption, he suggested, will result in a significant number of community banks being relieved of their current obligation to report under HMDA. If the HMDA rule’s 25 loan volume threshold for closed-end loans had been in place in 2016, he suggested, the percentage of FDIC-supervised depository institutions required to report would have fallen by more than 500 institutions, to slightly less than 50 percent of FDIC-supervised institutions. Overall, approximately 1,400 insured depository institutions would no longer have to report HMDA data. However, up to 450 non-bank lenders that previously did report will be required to report HMDA data going forward. After summarizing additional CFPB changes regarding the origination threshold for open-end lines of credit, Mr. Brown indicated most of the HMDA rule changes will become effective January 1, 2018. He further advised that the FDIC is working with other agencies as part of the FFIEC process in an effort to jointly develop examination procedures and guidelines related to HMDA implementation. In addition, the agencies are working to identify designated key data fields for HMDA testing and validation, and the FDIC issued a FIL describing the designated key fields on October 17, 2017. As a result, during examinations, FDIC staff will focus on reviewing the designated key data fields for purposes of HMDA testing. This means that the FDIC will not review all data field samples. In practical terms, this means FDIC examiners will generally review 37 data elements rather than all 110 as part of the review process. Moreover, the FDIC continues to focus on examiner training so HMDA reviews will be more efficient; continues to look for opportunities to communicate with banks on regulatory issues, including HMDA; and will continue to monitor HMDA implementation in order to evaluate the impact the rule is having on FDIC-supervised banks.

Ms. Eberley discussed a range of risk management issues including credit risk, interest rate risk and its impact on balance sheets, and liquidity. She then directed the members' attention to the Summer 2017 edition of "Supervisory Insights," included in the Committee materials, and noted that it included in-depth articles concerning community bank liquidity risk trends. She also called their attention to FIL-55-2017 announcing an interagency community bank teleconference on the topic of liquidity and funding risk management. Returning to the Supervisory Insights publication, she indicated that the article concerning the Bank Secrecy Act was written in an effort to eliminate some of the myths that surrounded that law and provide insights with respect to Bank Secrecy Act examinations and enforcement.

She then invited Mr. Storch to discuss the current expected credit losses ("CECL") accounting standard. Mr. Storch explained that the Financial Accounting Standards Board ("FASB") published its new credit losses accounting standard in June 2016. CECL applies to all financial assets carried at amortized cost (including loans held for investment and held-to-maturity debt securities), a lessor's net investments in leases, and certain off-balance-sheet credit exposures such as loan commitments and standby letters of credit. The standard applies to all FDIC-supervised banks and savings associations, including community institutions. The new standard will take effect in 2020 or 2021, depending on an institution's characteristics. It was adopted because, after the 2008 global economic crisis, standard-setters concluded that the existing approach for determining the impairment of financial assets, based on a "probable" threshold and an "incurred" notion, delayed the recognition of credit losses on loans and resulted in loan loss allowances that were "too little, too late."

Mr. Storch then discussed at length the key provisions of the new standard, including the application of the CECL methodology for estimating credit loss allowances; broadening the range of data that is incorporated into the measurement of credit losses to include forward-looking information; introducing a single measurement objective for all financial assets carried at amortized cost; related supervisory expectations; and regulatory reporting guidance. He recalled that the banking agencies followed-up the FASB's issuance of the CECL standard by releasing a joint statement in June 2016 on the new standard. Since then, he said, the agencies have issued two sets of frequently-asked-questions, first in December 2016 and then September 2017. The September 2017 publication combined all the FAQs into a single document so readers will have all the information in one place. Work is already underway on the next set of FAQs.

Mr. Storch observed that, despite the differences between today's incurred loss methodology and the new CECL methodology, the agencies believe the new standard is scalable to institutions of all sizes; smaller and less complex institutions will be able to adjust their existing allowance estimation methods taking into consideration the differences in inputs that need to be used. In fact, he noted, in order to meet the CECL requirements without the use of costly and complex models, the FASB intentionally built considerable flexibility into how the standard can be implemented, thereby recognizing the differences in risk profiles, sophistication, and resources of small versus large institutions. Moreover, the FDIC has been meeting with auditing firms that primarily focus on community banks in an effort to see what concerns they and their bank clients have, and it initially appears that the use of Excel spreadsheets, which many smaller banks use today under the incurred loss model, can still be acceptable with the proper controls and governance over them in order to implement the CECL methodology. Of course, Mr. Storch noted, the larger, more complex a bank's portfolio, the less likely Excel will be workable for these purposes. Overall, the FDIC is encouraging banks to start now, if they haven't started already, to prepare for the transition.

The Committee members then discussed at length their efforts to prepare for the transition to the new standard. Member Hartings raised the challenge of coordinating external audit firms and core processors. Mr. Storch noted that that the agencies had meetings with some core processors in 2016. At that point the standard was so new the processors were still in the learning stage. Mr. Storch reflected on the problem of "data gaps" and said that any communication involving you as the banker or your team with the bank's auditor and core service provider must begin with a common understanding of what currently available data should be maintained, and what data may need to be collected going forward, even though the bank does not have complete past historical data.

Member Howard observed that proxy data would likely prove very valuable where there is a data gap, and Mr. Storch agreed that the agencies encourage banks to do parallel runs to identify issues that need to be worked out, including any data gaps. Member Turner said he liked Mr. Storch's presentation and that it was more comforting than he knew because many parties are concerned with the complexity of the standards and the apparent need for sophisticated regression modeling to determine how economic factors have affected losses. Mr. Storch responded that the first thing for an SEC filer to do is talk to its auditors about expectations for the qualitative adjustments to historical loss experience that would come from forecasts. He indicated, based on discussion with other agencies, the agencies will not require regression analysis. However, for a very large, sophisticated bank that is doing complex credit risk modeling, regression analysis is probably a key input into their modeling in any event. For a community bank, Mr. Storch said, we do not require regression analysis for qualitative adjustments today and would not do so under the CECL standard. Member Beard asked if the FDIC expected more volatility in a bank's provision expense once the standard is implemented. After sharing his thoughts regarding volatility currently, Mr. Storch noted that if an institution anticipates some worsening of economic conditions, the institution should be reflecting that early on in the CECL loss estimate. That is the whole objective of the standard, he noted.

Bringing the meeting to a close, Chairman Gruenberg thanked the panelists for their presentations and thanked the Committee members for their service on the Committee. He said the Committee has been of enormous value to the FDIC, genuinely impacting the way the FDIC does business and providing significant insight into community banking. Chairman Gruenberg indicated that this was probably his last meeting as Chairman and it was his hope that the next FDIC Chairman continues with the FDIC Advisory Committee on Community Banking.

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There being no further business, the meeting was adjourned 2:42 p.m.

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

Minutes

of the

Meeting of the FDIC Advisory Committee on Community Banking

of the

Federal Deposit Insurance Corporation

Held in the Board Room

Federal Deposit Insurance Corporation Building

Washington, D.C.

Open to Public Observation

November 1, 2017 – 9:11 A.M.

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

Martin J. Gruenberg
Chairman
Board of Directors
Federal Deposit Insurance Corporation