

FEDERAL DEPOSIT INSURANCE CORPORATION

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ADVISORY COMMITTEE ON COMMUNITY BANKING

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MEETING

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WEDNESDAY,
OCTOBER 10, 2018

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The Advisory Committee convened at 9:06 a.m.
in the Federal Deposit Insurance Corporation Board
Room, 550 17th Street, NW, Room 6010, Washington,
D.C., Jelena McWilliams, Chairman, presiding.

PRESENT:

JELENA MCWILLIAMS, Chairman
MARTIN GRUENBERG, FDIC Board of Directors
CHRIS DONNELLY, President & CEO, Bank of the
Prairie
JAMES EDWARDS, CEO, United Bank, Zebulon, Georgia
CHRISTOPHER EMMONS, President & CEO, Gorham
Savings Bank
DAVID J. HANRAHAN, SR., President & CEO, Capital
Bank of New Jersey
JACK HARTINGS, President & CEO, The Peoples Bank
Co.
DANNY J. KELLY, President & CEO, Hometown Bank of
Alabama
KENNETH KELLY, First Independence Bank
ARVIND A. MENON, President & CEO, Meadows Bank
TIFFANY BAER PAINE, President & CEO, Security
Bank USA
MARY ANN SCULLY, President & CEO, Howard Bank
ALAN SHETTLESWORTH, Main Bank
JOHN M. TOLOMER, President & CEO, The Westchester

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Bank

JOSEPH W. TURNER, President & CEO, Great Southern
Bank

LOUISE WALKER, President & CEO, First Northern
Bank of Dixon

LEN WILLIAMS, President & CEO, People's
Intermountain Bank

ALSO PRESENT:

RUTH AMBERG, Assistant General Counsel, Legal
Division

LISA ARQUETTE, Associate Director, Division of
Risk Management Supervision

RYAN BILLINGSLEY, Corporate Expert, Division of
Risk Management Supervision

CHAD DAVIS, Deputy to the Chairman for External
Affairs

DOREEN EBERLEY, Director, Division of Risk
Management Supervision

DIANE ELLIS, Director, Division of Insurance and
Research

WILLIAM HENLEY, Associate Director, Division of
Risk Management Supervision

VIVEK KHARE, Counsel, Legal Division

M. ANTHONY LOWE, FDIC Ombudsman

RAE-ANN MILLER, Associate Director, Division of
Risk Management Supervision

PATRICK MITCHELL, Deputy Director, Division of
Insurance and Research

MARK PEARCE, Director, Division of Depositor and
Consumer Protection

Lisa Roy, Associate Director, Division of Risk
Management Supervision

BETTY RUDOLPH, National Director for Minority and
Community Development Banking

JAMES WATKINS, Senior Deputy Director, Division
of Risk Management Supervision

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CONTENTS

Introductory Remarks	
Jelena McWilliams	4
Committee Member Discussion of Local	
Banking Conditions	6
Supervision Update	
Doreen Eberley	81
Rae-Ann Miller	825
Ryan Billingsley	98
William Henley	103
FDIC Ombudsman Update	
M. Anthony Lowe	124
Industry Collaboration Initiatives	
Lisa Arquette	148
Betty Rudolph	161
James Watkins	171
Deposit Insurance Assessment Pricing	
for Small Institutions	
Diane Ellis	183
Patrick Mitchell	184
Interest Rate Restrictions Applicable	
to Less Than Well-Capitalized Banks	
Rae-Ann Miller	2164
Vivek Khare	224
Closing Remarks	
Jelena McWilliams	249

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

2 (9:06 a.m.)

3 CHAIRMAN McWILLIAMS: I think we're good
4 to begin. Good morning, everybody.

5 PARTICIPANTS: Good morning.

6 CHAIRMAN McWILLIAMS: That was a great
7 good morning. We are so pleased to have new
8 members of the committee with us, and I'll
9 introduce them in a second. So we have Louise
10 Walker from First Northern Bank of Dixon, Dixon,
11 California. Welcome, pleasure to have you here.
12 Alan -- where's Alan? Alan is over here. Alan
13 Shettlesworth from Main Bank, Albuquerque, New
14 Mexico. We have Ken Kelly.

15 MEMBER KELLY: Yes.

16 CHAIRMAN McWILLIAMS: Hi, Ken. Nice
17 to see you.

18 MEMBER KELLY: Good morning.

19 CHAIRMAN McWILLIAMS: From First
20 Independence Bank, Detroit, Michigan, and Jim
21 Edwards from United Bank, Zebulon --

22 MEMBER EDWARDS: Georgia. Zebulon,

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1 Georgia, yes.

2 CHAIRMAN McWILLIAMS: Zebulon, I got
3 it.

4 MEMBER EDWARDS: Very good.

5 CHAIRMAN McWILLIAMS: All right,
6 Zebulon, Georgia.

7 We expanded the membership of the
8 committee to ensure that we have representation
9 from different geographic areas of the countries,
10 of the country, also that we have more
11 representation from more diverse areas, so looking
12 at rural, agricultural, farm land, etc. We
13 also want to allow more time for dialogue and input
14 from the members, and for the new members, we're
15 actually very friendly, we engage nicely, so I
16 expect you to please, please provide your input.

17 This is not a perfunctory committee.
18 This committee is supposed to serve truly to get
19 your feedback. You can tell us what's happening
20 on the ground, and we will implement that into our
21 thought process and policymaking and move forward,
22 hopefully, in a, in a productive manner where we

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1 can create an environment where our community banks
2 can thrive, so we do expect you to engage, and I
3 put my new members close to me, so I can poke you
4 if you're not asking questions.

5 (Laughter.)

6 CHAIRMAN McWILLIAMS: You'll see from
7 the agenda today that we are starting off by hearing
8 from the committee members about your banks and
9 your communities. And I'm going to turn the
10 program over to Chad Davis, Deputy for External
11 Outreach who will serve as the moderator for
12 today's meeting. Again, welcome.

13 MR. DAVIS: Thank you, Chairman.

14 As the Chairman indicated, we're going
15 to start with presentations or just a discussion,
16 if you'd like to call it that, from the committee,
17 so for this session, I'm going to turn it over to
18 all of you. And we didn't just turn it to him cold.
19 We talked to him ahead of time, but asked John to
20 please kick it off, so, again, this is a very
21 flexible time. Please tell us about your markets,
22 your banks, whatever you find most relevant for

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1 this period.

2 MEMBER TOLOMER: Sure. Thank you very
3 much, Chad. I appreciate it. The Westchester
4 Bank was founded ten years ago. We are in the
5 Westchester market, which is a suburb of New York
6 City, and we are typically geared toward
7 small/medium-sized businesses and being able to
8 have a full suite of product for consumers as well.

9 What we're seeing in the market more
10 recently is there's a great deal -- loan demand has
11 been solid and growth has been in the 15-16 percent
12 range year over year. Deposits, on the other hand,
13 I think are a struggle that we're seeing throughout
14 the industry, not just in Westchester County or in
15 New York Metropolitan area, but I think nationwide.

16 One of the things that we're seeing is
17 some of the larger banks are looking to, I think,
18 bolster their liquidity and are offering higher
19 rates than normal, and so when you talk about the
20 normal rates nationwide, it tends to be very
21 different in New York, because you have regional
22 banks and larger banks offering 1.75 for money

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1 market rates and 2.5 for one-year CDs, and those
2 are -- creates a great deal of pressure for smaller
3 banks to be able to build their business.

4 You know, we've always said we want to
5 do well by doing some good in our market, and when
6 you have that pressure, it's certainly, you know,
7 has been difficult from a competitive standpoint.
8 The good news is with the tax cut, our
9 year-over-year profits are very strong, and even
10 if you back out the effects of the tax cut, we still
11 have fared very well.

12 We're lean. We utilize technology
13 where we can and consultants where we can to augment
14 what our employees are doing, so it's -- I think,
15 as we look forward, I think, banks have to really
16 look at what is going to happen to -- there's
17 greater pressure for deposit rates increasing,
18 and, of course, there's pressure from customers not
19 to increase our loan rates, and so, you know, with
20 the relatively flat yield curve, it's something
21 that we all have to consider as, how do you handle
22 your business on a going-forward basis?

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1 Thus far, we've been able to compete.
2 We're asset sensitive and -- but in terms of the
3 overall market, there's -- there isn't any lack of
4 competition, and, certainly, you know, we are --
5 have learned to put forward the loan proposals that
6 we think make sense for us and for our shareholder.

7 Fortunately, we've been able to win
8 more than we've lost, but you do sometimes lose to
9 banks that want to have a more aggressive approach
10 to terms and conditions, something we're not
11 comfortable with, and, also, there are pricing
12 considerations. Some of the larger regionals for
13 multifamily will -- are still below four percent,
14 which is beyond my comprehension as to how they can
15 do that effectively, but they are, and it's
16 something that we have chosen not to do and we'll
17 continue not to do that.

18 So, I think discipline is -- I don't
19 mean to pontificate, but I think discipline is the
20 order of the day of how you operate your business,
21 and looking at the deals you want to put forward,
22 for the credit quality you want to put forward, and

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1 recognize there's going to be pressure on margin,
2 and how you go about managing that is going to be
3 very important for the future strength of your
4 organization.

5 So, if there's anything that I didn't
6 cover, I certainly am open to any questions.

7 CHAIRMAN McWILLIAMS: Thank you.

8 MR. DAVIS: Great. Tiffany, can we
9 turn it to you?

10 MEMBER PAINE: You know, you didn't
11 talk to me beforehand.

12 (Laughter.)

13 MEMBER PAINE: I'm Tiffany Paine. I'm
14 from Security Bank in Bemidji, Minnesota. Just to
15 give you an idea where that is, we are four hours
16 south of Winnipeg and four hours north of
17 Minneapolis, so we are in a small rural community
18 that is very diverse.

19 We have -- in the 20-mile radius, we
20 have about 50,000 people and we have 10 financial
21 institutions competing for their business. That
22 does not include brokers or anything like that, so

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1 I'm going to say ditto, yes, what John said, but
2 exactly looking at your balance sheet on a regular
3 basis, managing that on a regular basis.

4 We have been fortunate enough to grow
5 over seven percent in our loans in the last two
6 years and over eight percent in our deposits in the
7 last two years. One thing that I know will come
8 up later is the reciprocal account conversation,
9 and that's a big thing for us, so I'll wait on that
10 conversation.

11 But what we are seeing in our markets
12 is a little bit of the, maybe loosening of
13 underwriting in some situations. You are seeing
14 people that are willing to, to get the money, again,
15 adjust their terms, adjust their rates, lock in for
16 longer, and you see customers shopping for that on
17 a regular basis.

18 What they're basing that on maybe, for
19 example, is they think they should get better terms
20 and better rates because their score on Credit
21 Karma is 800 and they come in and they want to debate
22 why Credit Karma is right, and the three agencies

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1 that you're pulling their credit report from are
2 wrong. So there's a little bit of misinformation
3 out there for the consumer and it's readily
4 available to them. And because they have this
5 information, they think that they should come in
6 and get these better terms.

7 We are seeing that that goes to the
8 fintech disruption a little bit. It's not just the
9 apps that you can get. The immediate approval,
10 which is also untrue, which to me falls under UDAP,
11 but it does take a longer term, and then the
12 question is, "Who's regulating them, and how is
13 that being taken care of?"

14 It's the Credit Karmas, it's the -- all
15 of that disruption coming in. It's the spam, it's
16 the phishing, it's the -- all of the different
17 technology aspects of it.

18 Then, what -- another thing that we are
19 seeing is that in the state of Minnesota, brokers
20 only have to take a test to get their license.
21 There's no continuing education that is required,
22 I believe, from them, and so they don't understand

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1 our smaller market, and so that actually is good
2 for us on one side of it, but it does create a bit
3 of a challenge.

4 We are starting to see customers trying
5 to stretch their limits, trying to push the ratio
6 limits, put little money down, borrow to fix up
7 immediately, so we're starting to see that, and to
8 help rein them in can be a bit of a challenge.

9 Manufacturing -- manufactured housing
10 is still a challenge. If we put the same customer
11 through our system and that customer will -- for
12 a manufactured home will come up denied or caution,
13 if we put a stick build in there, it's approved,
14 so I think in our area, again, in rural communities,
15 not everybody can afford a stick build house.

16 And construction is coming in over as
17 it typically does, so manufactured homes are good
18 opportunities. If you have a large farm or a
19 family farm and the parents give the kids some of
20 the acreage, to finance that manufactured home is
21 still a challenge and that's unfortunate, because
22 those are future customers we want to build.

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1 Credit consolidation companies are
2 popping up again, and it's a challenge. People are
3 getting stuck, and they, they don't read the fine
4 print, so eventually, they're coming back to us.

5 I have several topics, but I'm going to
6 pass it on, and we can discuss them in the future.
7 Thank you.

8 MR. DAVIS: Chris, could you go next?

9 MEMBER DONNELLY: Thank you, Chad.
10 I'm Chris Donnelly with Bank of the Prairie, \$140
11 million, two-location branch, a bank in Olathe,
12 Kansas. Olathe is a suburb in the southwest part
13 of Kansas City, Missouri metro, about 140,000
14 people and growing quite well.

15 The bank, we've experienced some
16 significant growth, and then back in January, we
17 kicked the brakes on pretty hard and then are
18 pushing them harder, because the small business
19 community is doing well. We're starting to see
20 some stress in the real estate market,
21 single-family housing construction.

22 In fact, we saw it start to trickle down

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1 from the larger more expensive houses, and they
2 were starting to slow early on in the year, and now
3 we're seeing it even down in the more affordable
4 housing, so we've really decided that it's probably
5 best to let somebody else get into that business.

6 And the small business sector by itself
7 -- and we're a well-diversified bank with real
8 estate, commercial, C&I, very little ag, but in the
9 ag that we do have is struggling still. Then --
10 and it does not appear to be anytime soon that that
11 will repair itself.

12 I think probably our biggest challenge
13 is gathering deposits. Our cost of funds has
14 increased pretty rapidly. As a small bank in a
15 metro community, it's hard to gather deposits. Our
16 headquarters is directly across the street from
17 Garmin International where there's 3,000 employees
18 and they're adding 2,000 more, and it's hard to get
19 those young engineers to bank with a small
20 community bank and bring their deposits in.

21 On a daily basis, I tell the story that
22 probably 500 electric, or electronic engineers,

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1 whatever they are, at Garmin walk through my
2 parking lot and go to a restaurant or go to the
3 convenience store across the street, and it's hard
4 to get them to come in and -- when you're not a large
5 regional and have all the technology, and so those
6 deposits are hard to find. And with the cost of
7 funding going up, it's hard to see how you can make
8 a profit in a small bank.

9 I was sitting with some of my colleagues
10 at a table this morning, and they were talking about
11 interest rates in the fours and fives for loans,
12 and we've started pushing six percent and we are
13 now seeing at that rate that customers stop
14 borrowing money.

15 Deals quit. They just won't do the
16 deal. And I don't -- I don't think they recall the
17 time when six percent was a really, really good
18 interest rate, and it still is a good interest rate,
19 but when we start to see that pressure, we start
20 to get concerned, and so that's why it makes sense,
21 for us at least, to maybe back off a little bit and
22 see where the markets are going to go. It's

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1 disconcerting to see good solid projects back away
2 when you get approaching to a higher interest rate
3 at six percent.

4 So, that's kind of it with Olathe, and
5 I'll pass to Len here.

6 MEMBER WILLIAMS: Great. Thank you.
7 Well, I'm Len Williams. I'm with the People's
8 Intermountain Bank, which is the bank associated
9 with People's Utah Bancorp holding company. We're
10 about a \$2.2 billion bank located just south of Salt
11 Lake is our headquarters, but we've got 25
12 locations throughout the state.

13 And it's been a -- it's been a pretty
14 good run here the last several years. The state
15 has a lot going for it. Favorable business
16 climate, tax rates, so there's been strong
17 in-migration. It's been the top two or three in
18 the country the last several years. Same with job
19 growth, same with income growth, so all of those
20 going for you have been very helpful to us and the
21 banks in our market.

22 A competitive area from a credit union

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1 perspective -- also, Utah is one of the states that
2 really encourages the ILCs, the -- and right now
3 as the last couple of weeks, there are four or five
4 applications in for new ones now, so we're starting
5 to see a little bit of bank charter application
6 growth.

7 The industrial loan companies are not
8 direct competitors for us in our market, but
9 they're direct competitors for all of us in all of
10 our markets. They actually go out nationally.
11 For their lending, they tend to fund themselves
12 predominately with brokered CDs, and other
13 sources, so it's -- it's good for the Utah Bankers
14 Association, good for the membership, the growth
15 and the support, and they tend to be fairly
16 innovative too, so we do have some collaborative
17 opportunities with those folks where we talk about
18 different ways they're funding their bank,
19 different type of technologies they're using to --
20 on their national scale, so that's been interesting
21 for us.

22 Some of the issues in our market,

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1 there's starting to be the affordability index for
2 residential housing. There's been a lot of
3 in-migration to where a lot of the local kids, the
4 folks growing up in the market, are having a hard
5 time affording new homes. That's becoming a bit
6 of concern, as is real estate concentration, but,
7 again, there's a focus in that area.

8 While there's virtually no new home
9 inventory for sale, you know, having been in the
10 industry for 40 years, my spider senses are
11 starting to tingle a little bit. It's just a
12 matter of when and how severe the next downturn is,
13 so we spend a lot of time now focusing on what we
14 don't even see yet, which is how do we prepare our
15 balance sheet, how do we prepare our funding for
16 a slowdown in the real estate market, which we think
17 will probably happen in the next couple of years
18 in our market.

19 So, it's been great for organizational
20 profitability. We've had record years the last
21 several years. It continues on at this point, but
22 we are seeing deposit -- you know, it was nice those

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1 first four rate increases, nobody raised their
2 rates. In these last three, people have gone, at
3 least in our market, rates have climbed
4 exponentially particularly for deposits, and we
5 continue to see that, so funding costs are going
6 up, margins are being squeezed a little bit, and
7 we continue to be concerned about that as well.

8 MR. DAVIS: Thanks, Len.

9 MEMBER HARTINGS: I'm the other
10 Peoples Bank in the group here. Jack Hartings.
11 I'm with Peoples Bank in Coldwater, Ohio. We're
12 about a \$500 million institution, 7 locations.

13 I was listening to the population size.
14 I think our county is about a 40,000 population.
15 The counties that surround us, roughly 50 or 60.
16 We're the number one agricultural county in Ohio,
17 Mercer County.

18 Agricultural is suffering, but the rest
19 of the economy is going well. I think our
20 unemployment in our county is less than three
21 percent right now. And we're starting to see
22 effects certainly on our own income, but from the

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1 tax changes, but several manufacturers.

2 We've got one in our area that's
3 building about a 500,000 square foot building.
4 They build forklifts. We've got a recreational
5 vehicle manufacturer in the area that's adding on
6 800,000 square feet. Those are just -- the dirt
7 is just being turned today, so those are going to
8 have some long-term effects.

9 And, you know, when I talk to the other
10 small businesses about why they're feeling maybe
11 good about the economy and expanding right now,
12 certainly, they look at taxes, they look at the
13 general economy, they feel the sense of a more
14 common sense regulatory environment, that's kind
15 of what they passed on to me, so things on that side
16 look good.

17 We're having a housing push as well.
18 It's just the really affordable housing as
19 construction costs rise. We're a fairly
20 substantial residential lender at our institution.
21 Haven't seen the rates slow that down yet, but I
22 think you'll see that in maybe these fourth and

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1 first quarter, because they mostly track the ten
2 year, and as you guys know, the ten years are --
3 is coming up the last couple of weeks.

4 When I talked to the other bankers in
5 the area and ourselves, we're starting to see
6 deposit pressure. When you're a banker, you first
7 look at the special rates on CDs, money markets,
8 but those rates are now creeping into all rates,
9 and so I think that's, that's maybe the change we're
10 starting to see over the last month, but most of
11 us still, at least in our general vicinity, have
12 fairly good lines.

13 It's been good loan growth, but most of
14 us have seen our growth moderate a little bit. I
15 think most of us are still growing in different
16 industries, depends upon what we're into.

17 Concerns out there, I know we didn't
18 talk about regulatory too much yet. The reg burden
19 of TRID I want to say is kind of behind us now for
20 two reasons. Number one, a lot of banks just got
21 out of mortgage lending, so I'm not sure that's a
22 good thing, but the rest of us that have stayed in

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1 it, if you give us a little bit of time, community
2 bankers are usually pretty good at handling
3 regulation, but you can't throw it all at them at
4 one time.

5 And we're getting used to e-documents.
6 There are talks to the CFPB about improving those
7 a little bit, making them a little bit better.
8 We're all getting used to beneficial ownership,
9 another latest reg burden on all of us. And the
10 biggest frustration that I have with beneficial
11 ownership is we have the same customers, and they
12 come in year after year. We have lines of credit,
13 we have those, but every year, I've got to have this
14 beneficial ownership form.

15 And a lot of my customers I probably
16 have had their lines of credit for ten years. In
17 their file, it's going to be ten beneficial
18 ownership signed forms, which -- you know, I get
19 one resolution from these folks when they come in,
20 and if they don't change their organization, I
21 don't get another resolution. I get their ID one
22 time until they change their ID, so those are just

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1 a little bit of frustrations.

2 I know that the regulatory agencies are
3 looking at the simplified capital rules. We think
4 that's very important. Again, we're a \$500
5 million bank. I would just ask -- I think it goes
6 to the heart of our franchise value that you
7 consider that in an 8 percent minimum and not 10,
8 because 8 is really 9 and 10 is really 11, because
9 as a banker, if you put the minimum at 10, probably
10 not going to operate at 10, I'm going to operate
11 at something higher than that.

12 And, again, those are all little pieces
13 that help us as community banking. I've been
14 around a little while. I've been president at my
15 bank for about 28 years, I'm previous chairman of
16 ICBA, so I get a chance to talk to a lot of bankers.

17 And the one thing, I think, we got give
18 ourselves credit a little bit, we're pretty good
19 at cycles. I know we're seeing deposit pressure,
20 but in some respects, we saw the growth on our
21 depositor backs, and so I don't feel too bad if I
22 got to pay a little bit more interest rate. I mean,

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1 I certainly have to balance that, I understand
2 that, but that's -- that's kind of how we look at
3 it as more of a holistic way of taking care of our
4 customers, so we're confident that the economy will
5 stay fairly strong in our area.

6 Concern with liquidity, concern with,
7 you know, the rate burden going forward, but our
8 bank is 115 years old, a little over that right now,
9 so we hope we've got another 100 years in us, so
10 --

11 MR. DAVIS: Alan.

12 MEMBER SHETTLESWORTH: Hi. I'm Alan
13 Shettlesworth, Main Bank in Albuquerque, New
14 Mexico. I looked at our balance sheet this morning
15 in my hotel room, and we're about a \$139 million
16 in total assets today. Our bank started in
17 November 1, 2005, and I can tell you that was both
18 the best of time and the absolute worst of time to
19 start a bank.

20 We ended up acquiring a bank with about
21 30 million in total assets - helped advance our,
22 I guess, our game plan going forward, so we've had

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1 an acquisition since that time period and a lot of
2 business cycles and a lot of business changes for
3 us.

4 Our specialty right now is primarily in
5 the commercial, in commercial real estate space.
6 That tends to be what we know. We are small, and
7 I'm proud to report that we just made a hire last
8 month, so that brings our employee base to a
9 whopping 13 employees, and it puts a little bit of
10 strain on our folks back home, because when I'm here
11 and they're away -- when I'm here away from the
12 bank, they have to coordinate bathroom breaks a lot
13 better than---

14 (Laughter.)

15 MEMBER SHETTLESWORTH: For us, you
16 know, the deposit market in New Mexico is 40 percent
17 controlled by two big banks, Wells Fargo and B of
18 A, and so we have some of a benefit from there,
19 because those banks have not really increased their
20 rates.

21 We have started to increase our rates
22 because we are growing and we continue to grow.

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1 We'll probably hit between 8 and 12 percent total
2 asset growth and total loan growth, and so we are
3 currently actively raising our costs of funds right
4 now, and so our costs of funds in the last 12 months
5 will have more than doubled, and that is putting
6 some margin compression. That's presenting some
7 challenges for us.

8 We, in 2010, got into the mortgage
9 business. We hired a group that was pretty
10 successful and that had been basically kicked out
11 by the, by the recession. Since they didn't have
12 a lack of the funding or liquidity for their
13 mortgage loans, we brought them in-house.

14 Did that program for about 2015, and
15 then we looked back and realized at the end of 2015
16 that our cost to produce a loan had more than
17 doubled exclusively because we had hired more
18 bodies for compliance burden, and so it was
19 becoming an unreasonable burden for a bank of our
20 size at that point.

21 We had more employees at our mortgage
22 division than we did at our commercial bank. In

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1 order to make that successful long-term, we thought
2 we would need to have doubled the size of our
3 production and that would have probably put too
4 much pressure on our capital and too much risk for
5 that, for that piece, and so we exited the business
6 in 2015. Since then, we've continued to grow.

7 In our market -- in Albuquerque, I'm not
8 quite sure if we have, if perhaps technically we
9 have made it out of the recession, but at such a
10 slow pace that by the time, you know, the next
11 recession comes around, I've heard the r-word said
12 for 2020 that's potentially when the next recession
13 is coming.

14 I'm just concerned -- our big concern
15 is that Albuquerque will just have made it out of
16 the recession in time for the other one, and so
17 that's a real concern of ours, but we're -- we're
18 -- because of our small size, in spite of the fact
19 that Albuquerque isn't doing incredibly well
20 economically compared to surrounding cities and
21 surrounding states - Arizona, Colorado and Texas,
22 we're still able to grow in spite of all that,

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1 because of our size.

2 We have one location and that is
3 probably our big challenge and we are strategically
4 going forward. We're not interested in branching.
5 We're not interested in multiple branches. We
6 lend exclusively in our market, which is the
7 Albuquerque area, and we're going to continue to
8 do so.

9 We should be able to get to 500 million
10 before we need to worry about any other branches,
11 and so that's another challenge for us. In some
12 regards, I feel like we are closer to an
13 Internet-based bank than we are to a local
14 community bank, because of the one location, so
15 that creates its problems and challenges for
16 getting depositors, certainly for the younger
17 generation.

18 Yes, so -- so we're doing fine, but I
19 just say because of our size, and so we're
20 continuing to do what we've always done. In our
21 local market, I would say that some new trends that
22 have started up this year have been out-of-state

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1 lenders coming in to Albuquerque originating a lot
2 of SBA 7a transactions. Those are the
3 transactions that you can do a lot of real
4 estate-based transactions.

5 A lot of folks are getting very
6 aggressive terms with 10 percent down and 25-year
7 amortization loans, and we -- we wouldn't do those
8 loans even with an SBA guarantee, and so that is
9 probably one new recent trend we're seeing.

10 When we started the year, there were 38
11 banks that were based and headquartered in New
12 Mexico, and by the time we get to the end of the
13 year, we're going to have 36 banks. It's
14 unfortunate to see that from our standpoint, but
15 there are other larger out-of-state banks that are
16 coming in to New Mexico, I think, almost
17 exclusively for access to our low cost of funds,
18 our deposit market, and so while that's a very big
19 negative for New Mexico, that's a huge positive for
20 Main Bank as we look around and we're about the only
21 locally owned, based bank there in Albuquerque.

22 So, thanks for having me.

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1 CHAIRMAN McWILLIAMS: Thank you.

2 MEMBER EDWARDS: Good morning. I'm
3 Jim Edwards. I'm CEO of United Bank, which is
4 based in Zebulon, Georgia, which is only about 40
5 miles south of the world's busiest airport in
6 Atlanta. Interestingly though, the county where
7 our bank is headquartered has just 2 stop lights
8 and less than 20,000 people in the county, so we
9 operate in 10 counties, contiguous counties sort
10 of in a southern arc around the southeast and west
11 side of Atlanta, and it's an interesting mix.

12 The communities closer to Atlanta are
13 more suburban, and then we go all the way down to
14 about 60-70 miles south of Atlanta, and those
15 communities are more rural. Bank is 110 years old.
16 It's a Sub S bank, and I'm really proud to be the
17 third generation in my family that's involved with
18 running the bank.

19 We also have trust and mortgage, pretty
20 large trust and mortgage businesses. And the
21 bank's loan mix is really -- we're a traditional
22 community bank. I mean, we do a little bit of

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1 everything from consumer to C&I to real estate
2 lending.

3 I think many of you in this room
4 remember, or I certainly do, how challenging the
5 recession, the great recession was in Georgia from
6 a banking perspective. We lost about a third of
7 our bank charters during that, during that time.

8 In one of the counties next to us, we
9 lost every community bank that was headquartered
10 there, so we, fortunately, are little bit further
11 away from the epicenter when things turned really
12 bad there, but I think the good news today is that
13 the Georgia banking market is back and I think it's
14 healthier and I think many of the lessons that were
15 learned back in that recession were learned well.
16 And we are not seeing a real loosening of credit
17 standards in that market now and that's good to see.

18 We are seeing, however, a good bit of,
19 I guess, pricing pressure on the loan side, which
20 is, which is somewhat interesting with rates
21 rising. I think there's been this, a little bit
22 of a feeling that rates just weren't going to rise,

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1 that never really was going to happen, and
2 certainly as we've seen this week and over the last
3 couple of years, that is beginning to happen, and
4 so we're starting to see some pressure on deposits
5 just as the other bankers here have mentioned.

6 I think it's going to be interesting to
7 see what happens with all of that, because earlier
8 in my career, you know, half of our balance sheet
9 would be made up or better of local CDs. We've seen
10 a transition out of that due to low interest rates
11 over the last five or six years here, so we're
12 trying to pay a lot of attention to what happens
13 with those deposits, because unlike earlier in my
14 career when my primary competitors were right
15 across the street from me, now the -- our
16 competition we feel like both on certainly the
17 deposit side and from a growing perspective on the
18 loan side are banks all over the place and nonbank
19 lenders and nonbank opportunities to invest money,
20 so I think we, just as bankers, have to be very
21 cautious and concerned about that and not just say,
22 "Well, this is -- we don't have a problem because

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1 this is our little market here, we're okay."

2 I think consumers are looking, as we've
3 heard from some of the other bankers here, they are
4 spending more time in comparing and there's not
5 that reluctance to maybe do, to work with somebody
6 out of state that there was, that there was in the
7 past.

8 But, you know, from a portfolio
9 standpoint, you know, loan quality metrics are
10 frankly as good as I seen in my career. Just
11 charge-offs are virtually nonexistent, problem
12 loans are extremely low, and so I like the, what
13 one of the former speakers said, you know, "That
14 makes my spider sense tingle," too. You know, it
15 feels almost a little too good to be true here, and
16 I think we have to be careful in this type of, this
17 type of environment here.

18 We're spending a lot of time trying to
19 figure out how to stay on top of technology for our
20 consumers as well. That is a challenge. One of
21 the bankers who was, spoke previously about his
22 Garmin customers potentially, while we don't have

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1 that, you know, gosh, anybody under the age of 40
2 it seems like is if you don't have the latest in
3 technology, it's a challenge.

4 And, so, for -- even though we're a
5 billion three, it's still a challenge for us to
6 figure out how to implement the right technology
7 to work with, and there's some really good
8 solutions out there, but frankly, trying to make
9 those solutions work with our core data providers
10 has been a challenge for us.

11 I think the cores are at least saying
12 the right things about trying to integrate with
13 more, with some of the latest technology, but
14 that's something that we're spending time working
15 on and trying to stay out in front of.

16 And, I think, finally, one thing I'll
17 mention is a challenge that we're facing and
18 spending time working on is how do we recruit the
19 next generation of bankers. In Georgia, you know,
20 the first thing that happens when you get into --
21 that happened during the recession was people
22 stopped training, they cut training budgets, they

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1 cut hiring staff, new staff, and so ten years on
2 now, in some cases, we turn around and we look for
3 that next generation of leadership and it's not
4 there.

5 And I'm talking from an industry
6 standpoint, but we've -- and we sort of have over
7 the years, you know, the typical pipeline was we
8 would, we would hire the young person who maybe got
9 out of college, went to work for one of the regional
10 banks, and was ready to come back home, and they
11 were well trained. That market is not really out
12 there as much.

13 We find that most of the larger banks
14 are training more specialists, and so for the
15 community bank world, we need more of a generalist,
16 and so we've just had to start our own training
17 programs basically.

18 And we're doing that now, and,
19 fortunately, are having some good results with
20 that, but I think as an industry, we've got to work
21 to figure out how to attract, to show young people
22 that banking can be a very satisfying and good

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1 career. And I think we've got some work as an
2 industry to do there, but I do think that there are
3 very good opportunities to do that, but we've got
4 to -- we've got to get out in front of that, I think,
5 and we're working hard to do that in our
6 institution, so.

7 This is my first meeting and it's a real
8 honor to have a chance to do this, and I appreciate
9 the opportunity to participate.

10 CHAIRMAN McWILLIAMS: Thank you.

11 MEMBER EDWARDS: Thank you.

12 CHAIRMAN McWILLIAMS: Thank you very
13 much. I won't have to poke the new members - they
14 are talking. This is good.

15 (Laughter.)

16 MEMBER WALKER: Yes, so I agree with
17 Jim. It's an honor to be here, so thank you. I'm
18 Louise Walker. I'm the CEO of First Northern Bank,
19 which is a community bank in Dixon, California,
20 which is located between Sacramento and San
21 Francisco.

22 We are \$1.3 billion organization, 68

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1 percent loan-to-deposit ratio, which is unique for
2 our area, because a lot of the banks are running
3 in the 90s to 100, 8 percent loan growth, and about
4 5 to 6 percent deposit growth. We operate in five
5 counties in that area, so very metro, but yet, rural
6 at the same time.

7 And right now, we're working on
8 digitizing everything, but to just give you an idea
9 of the market conditions in our area. The
10 Sacramento Valley region right now is very strong.
11 In the area of regional housing, the median closing
12 price on a detached home is around 470,000,
13 attached homes 592,000, homes priced between
14 400,000 and 500,000 are the most active if you can
15 find it, affordability is a huge issue in
16 California.

17 And right now in the Sacramento area,
18 it's about a 35 percent affordability ratio.
19 Supply is extremely tight. To give you a feel for
20 that, we need about 9,000 homes per year. At the
21 peak, we were building 17,000 to 18,000. And last
22 year and this year, we're at 6,000.

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1 Again, affordability is an issue.
2 However, we are seeing buyer fatigue and price
3 increases and also increasing rents and that's a
4 real difficult situation, because it's hard for
5 people to save if their rents are continuing to go
6 higher.

7 The biggest thing I hear out there
8 between -- in the home building area and talking
9 to home builders and business owners is this
10 shortage of labor. Labor is a huge issue,
11 especially in California, and because of that,
12 that's a natural kind of governor on overbuilding,
13 like we did last time.

14 There are also, right now, is in the
15 residential housing area adherence to strict
16 under-guiding -- underwriting guidelines, higher
17 interest rates, and the impacts of new tax reform
18 as reasons for why we think the housing market will
19 continue to be stable.

20 And -- but, again, we need more
21 affordable housing. The cost to build, about
22 one-third of the cost is for governmental fees.

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1 Also -- now, I'm going to move to the commercial
2 real estate area.

3 Again, that area is very strong.
4 Valuations though, we think are stretched compared
5 to risk-free alternatives. As interest rates
6 increase, we're going to start seeing a repricing
7 of risk assets, and so that's very much a concern
8 for us. We're seeing aggressive lending in the
9 commercial real estate area.

10 And I can give you some examples, but
11 I'll give you them later. Because some of the
12 banks that are running between the 90 to 100 percent
13 loan-to-deposit ratios are focused on commercial
14 real estate, and so because of that, we're seeing
15 deposits become, become an issue, become an issue.

16 We -- on the commercial small business
17 side, strong business conditions, again, the
18 biggest issue is the shortage of skilled labor,
19 especially in our area, because of the wild fire
20 damage that was done, so it's very hard. We're
21 getting labor coming in from other states. And in
22 California, regulation and higher labor costs are

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1 an issue.

2 Ag -- in the area of ag, crops grown in
3 our market are strong. We build, not build, but
4 we grow a lot of permanent nut orchards, rice,
5 tomatoes, grapes. We are seeing a steady climb in
6 bearable acres. Our concern in this area is the
7 dollar and its impacts on commodity prices.

8 Also, water is an issue. It continues
9 to be a challenge. California has passed a law
10 where local management of underground water will
11 be implemented, and so we know that will impact
12 crops and land prices.

13 So, overall, our markets are doing
14 well. Although, we are seeing -- because we also
15 are close to San Francisco, what we're seeing is
16 because of home affordability, a lot of the
17 population is being pushed out up into our area.

18 CHAIRMAN McWILLIAMS: Excellent.
19 Thank you.

20 MEMBER WALKER: Thank you.

21 MEMBER KELLY: Good morning. I'm
22 Kenneth Kelly. I serve as Chairman and CEO of

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1 First Independence Bank in Detroit and would like
2 to say to Chair McWilliams, thank you so much for
3 allowing us to join this committee and represent
4 our industry, in particular, in the Detroit,
5 Michigan area.

6 Our bank is roughly 250 million in
7 assets. It's been in existence since 1970, so we
8 are in our 48th year. Our bank has predominately
9 been based on three prongs. One has been the
10 residential markets. We've also had a fairly
11 strong commercial practice along with equipment
12 leasing.

13 As many of my colleagues mentioned
14 earlier, we have had to really cinch back on the
15 consumer lending aspect, because it just has not
16 been as profitable in trying to manage our ratios.
17 Our challenge right now really has been focused on
18 ensuring that we are profitable.

19 For a bank our size dealing with the
20 compliance issues -- I heard one of my colleagues
21 speak of -- it becomes very challenging for us to,
22 to do things in a profitable manner. For instance,

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1 in the residential market, we have had a challenge
2 in just running that business in a way that's been
3 profitable, but we've made a commitment to the
4 people of Detroit that we were going to be in that
5 business.

6 And, so, what we've done is try to
7 continue to streamline and look at ways that we can
8 make mortgages in such a way more affordable from
9 an in-house practice perspective, but that is a
10 very big challenge, so regulatory aspect of that
11 is something that we continue to try to address and
12 try to adjust to, but it's one of those areas that
13 it's just really challenging for us from the
14 residential mortgage side.

15 When I think about our overall economy,
16 I will tell you the state of Detroit is very good.
17 If you reflect back maybe ten years ago when you
18 saw what was going on in the auto industry, and so
19 as the auto industry, so you saw the tail of
20 Detroit.

21 Today, you are seeing a change in the
22 momentum within the city. There have been quite

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1 a bit of investments in some of the, I'll call them,
2 people who have a large stake in the city, such as
3 Dan Gilbert and many others, that has really
4 created a resurgence in Detroit, and Detroit has
5 become more of a destination than it was ten years
6 ago.

7 That has brought more interest into
8 looking at creating and starting businesses in
9 Detroit. It has created an opportunity for more
10 collaboration. And I can say publically, we've
11 done a collaboration with Chemical Bank, which is
12 the largest bank in the state of Michigan, and so,
13 we're seeing more of a collaborative effort around
14 Detroit and looking at ways that we can improve
15 banking, because banking is the cornerstone of
16 overall economic development.

17 I'd also like to make a quick comment
18 as the incoming chair of the National Bankers
19 Association, which has really been the voice of
20 minority banking since 1927. Some of the
21 challenges you heard my colleagues talk about
22 really impact minority banking.

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1 And I can tell you firsthand for us, one
2 of them is capital. In fact, if you look at our
3 ratios today, we're actually having to manage to
4 capital. We could grow easily in the double-digit
5 range from a long-growth perspective, but we're
6 trying to manage our capital at this point in time.
7 And I would tell you that's a theme that definitely
8 runs through many of the minority banks in the
9 country.

10 The other items I will tell you, one of
11 my colleagues mentioned a moment ago, is succession
12 planning. When you go from a market that had
13 15,000 banks and the luxury of navigating 5,600
14 banks, everyone is managing all their costs in a
15 way that they're trying to manage their, their
16 ratios of ROA and ROE, and so you just do not have
17 the luxury of bringing in succession planning.

18 And I will tell you, for us, that's very
19 challenging, because I can't just go hire that new
20 hire right out of school. I'm waiting on them to
21 go get trained by one of the bigger houses, which
22 then, I can't afford to bring them in, because they

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1 make too money over there, and, so, my point there
2 is as we think about this industry, we've got to
3 think about it a little bit differently in how we
4 bring in talent, especially for small
5 institutions, and be creative in dealing with that.

6 The other topic I will bring up is, and,
7 I think, one of my other colleagues mentioned this,
8 is how do we really be attractive to the millennial
9 generation. We think they think differently, but
10 they just think in a different manner. I won't say
11 it's different.

12 The point I'm trying to make is when I
13 look at my customer base, my customer base has a
14 tail end to it relative to the demographic of age.
15 And when I look at my long-term sustainability, I
16 know I've got to figure out how to become attractive
17 to that age group in such a manner that we can be
18 prosperous going forward, not 5 years from now, but
19 10, 15 and 20 years from now.

20 And, so, I want to have -- I want to
21 mention that because as you think about it from a
22 regulatory perspective and you look at the fintechs

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1 that are out there, and I mean, I heard Credit Karma
2 mentioned by one of my colleagues, but there are
3 others that are out there who are going to be
4 attractive to a demographic that could change all
5 of our businesses, and so from a regulatory
6 perspective, my suggestion is to think through how
7 can we in a way create a marriage there in such a
8 way that is not disruptive to these institutions
9 that are critical to our community.

10 And my point being as I talked about
11 capital, I can put a business plan together to do
12 an app and to deal with fintech and can raise money
13 a lot faster than I can with a solid business that's
14 been in business for 48 years, so I'll end with that
15 comment.

16 CHAIRMAN McWILLIAMS: Thank you.

17 MEMBER EMMONS: Good morning. I'm
18 Chris Emmons. I'm the CEO of Gorham Savings Bank
19 in Portland, Maine. We are a \$1.2 billion mutual.
20 I'm not sure that there are many mutuals
21 represented at this table today, but it's -- we are
22 celebrating our 150th year this year.

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1 The Maine -- if you're not familiar with
2 Maine, population, total population of about 1.3.
3 We are in the southern part of the state. And the
4 southern part of the state is the most, is the most
5 productive from an economy perspective. Two hours
6 roughly from Boston. Go Red Sox.

7 (Laughter.)

8 MEMBER EMMONS: So -- and a lot of the
9 trends that we're experiencing in southern Maine
10 are reflective of what's happening in the rest of
11 New England, and in particular, liquidity and real
12 estate are the two areas that, that we're all
13 focused on.

14 You had mentioned, I think, your
15 loan-to-deposit was 65 percent somewhere, yes, so
16 we're 130 percent loan-to-deposit. We manage to
17 our capital as well, as a mutual. Our only source
18 of capital is through earnings, so it's important
19 for us to have the eye on the bottom line.

20 It's -- our greatest challenge today is
21 liquidity. We're seeing some of the same
22 pressures that others have spoken about regarding

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1 customer source deposits. Our strategies have
2 been supplemented a little bit by the fact that
3 we're seeing a number of the larger institutions
4 shedding branches in our markets, and so with a
5 strong CRM system, we're able to identify
6 opportunities and take advantage of some of those
7 customers that are leaving the larger
8 institutions.

9 We talked about workforce, meet the
10 challenges around workforce. Interestingly, we
11 are the oldest state in the country. We are
12 challenged by our young, our young residents moving
13 out of state, graduating from college, and seeking
14 their fortune outside of Maine, so we're
15 particularly challenged around how to attract
16 people into our workforce.

17 We have a program at the bank. It's a
18 millennial group that we've put together that we're
19 not quite ready to turn the bank over to them, but
20 if given the opportunity, they would gladly take
21 the reins.

22 They are very helpful in setting the

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1 pace on technology and the adoption of technology
2 and they, you know, they are a -- within themselves,
3 they are a great source of attracting other, other
4 young people to our, to our institution, so -- so,
5 I think, asset quality at our institution has been,
6 has been exceptional. Our challenge is really built
7 around the liquidity.

8 Real estate, I can tell you that we all
9 have our eye on a proverbial bubble. I think,
10 southern Maine, in particular, is starting to see
11 real estate prices that are reflective in the
12 Boston market, so we're paying attention to our
13 underwriting and making sure that, that we have
14 strong recourse in all of our, all of our
15 transactions, but market has been pretty solid in
16 southern Maine, and, I think, we got another 150
17 years in us, so thank you.

18 CHAIRMAN MCWILLIAMS: Thank you.

19 MEMBER SCULLY: So, I'm Mary Ann
20 Scully. I'm the CEO of Howard Bank. Howard is a
21 \$2.1 billion bank headquartered now in Baltimore
22 and started in 2004, so clearly, a lot of organic

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1 growth and a series of acquisitions over the last
2 14 years that allowed us to do that, as did
3 diversifying our capital sources. We became an
4 SEC registrant in 2012, and that access to the
5 institutional markets funded a lot of that growth.

6 From an economic perspective, I think,
7 like most of the people around the table, you know,
8 the local economy is strong. While it's not the
9 D.C. market and often suffers from a comparison to
10 the D.C. market, it benefits by the contiguous
11 nature. Many of our customers do a lot of business
12 in greater Washington.

13 I think probably the unique element
14 about our local economy, maybe unique to this
15 table, is the fact that we've focused on small and
16 medium-sized businesses almost exclusively. When
17 we started the bank in 2004, we made a decision to
18 not really try to attract mass market retail as we
19 were concerned that even then it was largely a
20 big-bank game and that we would not be able to
21 compete successfully.

22 And the focus on the small and

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1 medium-sized businesses has served us well, but the
2 market that we serve, being greater Baltimore, is
3 probably one of the greatest examples of the income
4 inequality in the country side-by-side.

5 We were formerly headquartered before
6 our last acquisition in Howard County. Howard
7 County is the fourth wealthiest from a household
8 income standpoint, fourth wealthiest county in the
9 United States, and it sits right next door to
10 Baltimore City, which is clearly one of the most
11 challenged local economies.

12 And that certainly impacts us probably
13 more from a community development, a philosophy
14 perspective. I mean, we have plenty of places
15 around Baltimore City in which we do business, but
16 that sincere desire that we have as a community bank
17 to help the city is a huge challenge and creates
18 a lot of noise, and some of it impacts the ability
19 to attract and retain talent when we moved our
20 headquarters back into the city.

21 Generally speaking, what we're seeing
22 from a commercial standpoint is, I would say

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1 strong, but not as robust C&I growth as we would
2 have anticipated. And what we've observed over
3 the last 20 months is basically that many of our
4 C&I customers are taking the gains that they
5 received from the tax law changes and are investing
6 it into their businesses, which is good, so
7 employment growth, but at the same time, we're not
8 seeing them so confident that they're moving back
9 into a traditional borrowing mode.

10 So, for example, we see our line usage
11 is much lower than it was historically. I would
12 say many of our business customers remain more
13 cautious than we would have anticipated.

14 We're concerned about the CRE market,
15 the non-owner-occupied CRE market in particular.
16 That's probably the one market where we're seeing
17 some of those late in the cycle evidences of lack
18 of underwriting discipline in terms of a lot more
19 non-recourse financing being done, extension of
20 interest rate terms.

21 I mean, we're seeing commercial banks
22 offer fixed 15 and 20 years, not the traditional

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1 5- or 7-year fixed-rate financing. We're seeing
2 a much higher loan-to-value, so a lot of things that
3 begin to look reminiscent about 2005 and 2006.

4 And, then, of course, we're seeing in
5 the CRE market locally a lot of nonbank
6 competitors, so we're seeing private equity funds,
7 we're seeing insurance funds. Again, not unlike
8 the C&I example that I gave, just, I think, examples
9 of still a lot of liquidity in the market and the
10 impact that that has on structure and on pricing.

11 We have a relatively strong housing
12 market. I think like some others have talked
13 about, the housing market is being adversely
14 impacted however by a significantly rising cost of
15 development and construction, the development,
16 just the scarcity of land, and so much higher prices
17 for land.

18 Much higher development costs,
19 especially in some of those strong parts of greater
20 Baltimore where there's not necessarily a desire
21 on the part of the counties to see an influx of
22 people, and so they're making it more difficult and

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1 more expensive to develop, so before you even put
2 a stick on the property, you're seeing much higher
3 costs of the land acquisition itself and the
4 development, and then the stick construction has
5 increased dramatically.

6 And what that means is that in our
7 market, you're starting to see the small and the
8 regional home builders come under much more
9 pressure, because it's the national builders that
10 are able to compete. And, obviously, those
11 national builders are not going to be our natural
12 customers.

13 We've been fortunate, I think, because
14 of our focus on the small and medium-sized
15 businesses that we've -- while we've certainly seen
16 the deposit pricing pressure that others have, in
17 particular, because of credit unions, a lot of
18 credit unions in our market that are very
19 aggressive on the pricing side and because of some
20 of the internet players and not the, just the
21 traditional internet players, but Goldman Sachs
22 with a lot of our private banking customers is very

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1 competitive on the money market side, but at the
2 same time, we've been able to continue to acquire
3 a lot of transaction deposits as our commercial
4 business has grown, and so our deposit betas have
5 changed, but have not changed as rapidly as others
6 have, but I think like all of us around the table,
7 we're certainly not just focused on the cost of
8 funds, but on the appropriate emphasis on
9 liquidity, but also, and I know we'll talk about
10 it later today, some of the definitions of
11 liquidity and some of the definitions of high
12 volatility deposits and how high costs of deposits
13 might affect some of those definitions. And as a
14 bank with 103 percent loan-to-deposit ratio
15 certainly looking forward, that would concern us.

16 I think -- I think that we're certainly
17 advantaged being in a metropolitan area, wealthy
18 suburban area from a talent attraction standpoint
19 compared to some of my colleagues around the table
20 in more rural areas, but I would say that we have
21 the same competition for young talent when we look
22 at long-term succession planning.

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1 And one of the things that our greater
2 size has afforded us the ability to do is that this
3 year, we've actually restarted a commercial
4 training program and concluded, like others around
5 the table, that we can't really continue to rely
6 on attracting very expensive, albeit, experienced
7 talent from some of our competitors, but it's much
8 too new an initiative to determine whether or not
9 it'll be successful.

10 I don't think that we think we're going
11 to be able to go back to the '80s, but we're hoping
12 to be able internally grow a little bit more of our
13 talent. And that's it.

14 CHAIRMAN McWILLIAMS: Okay. Thank
15 you.

16 MEMBER MENON: Good morning. I'm
17 Arvind Menon from Meadows Bank. We're
18 headquartered in Las Vegas. We've got a couple of
19 branches in Reno. We also have a branch in
20 Phoenix, Arizona.

21 As well as we do a significant amount
22 of SBA lending around the country and we've got

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1 about six LPOs in five western states going all the
2 way far as Texas and California and Oregon and
3 Washington.

4 Nevada has always been a boom and bust
5 state. Things can be looking rosy at one time, and
6 very soon, you hit the depths. The Great Recession
7 was no exception as we were hurt badly. Some say
8 we were ground zero for the Great Recession. That
9 may or may not be true.

10 Hearing, you know, some of your talk,
11 you lost a lot of banks in your markets as well,
12 so we are no exception from that standpoint, but
13 our economy has been pretty much, not diversified
14 enough if you will. That's been the problem in
15 Nevada.

16 The primary drivers have been gaming,
17 tourism and construction. And all three of them
18 have pretty significantly affected construction to
19 begin with during the loose lending standards. I
20 believe most of the home builders and office
21 builders felt, build it and they will come, and that
22 philosophy soon turned out to be wrong.

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1 And when the recession hit us, people
2 stopped building, you know, offices laid vacant.
3 Office vacancies were as high as 25 and 26 percent,
4 and so it was really a lot of, a lot of pain along
5 in every corridor if you want to look at it from
6 that standpoint.

7 Reno was hit hard earlier because
8 Indian gaming or gaming in tribal areas took over
9 some of the gaming out of Reno, and people could
10 stay in California and not have to come all the way
11 to Reno to gamble, and so Reno, we noticed even
12 earlier before the Great Recession hit us, and
13 we've had to kind of change our economic base, if
14 you will, and consequently, there's been a little
15 bit more diversification of the economy.

16 The recovery really started about six
17 or seven years ago. And since then, it has been
18 a pretty steady upward curve with all of the
19 indications being that the economy is still going
20 strong. Vacancies are down. Office vacancy is
21 down to about 15 percent, which is high by many
22 standards, but when I said -- what I said earlier

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1 was 25 percent occupancy -- vacancy I should say,
2 so compared to that, there's been a lot of progress.

3 In-migration has always been strong.
4 Being part of the Sunbelt states, retirees have
5 come in, into Nevada mostly from the Midwest, and
6 more recently, a lot of people from California. We
7 love California because California just drives
8 people and businesses out of that state.

9 (Laughter.)

10 MEMBER MENON: And properly being
11 situated next to it, we are a big beneficiary of
12 that. We get a big significant number of
13 businesses relocating, especially into the Reno
14 area, and some to the Las Vegas area as well.

15 As you might have heard, Tesla, the
16 electric car manufacturer, put a factory in Reno.
17 It's a 5.5 million square foot building and it's
18 supposed to grow to about 10 million, so we'll see
19 how big it is. It's huge.

20 Now, Tesla has had their own problems
21 lately, you've all heard about that, so we'll have
22 to see how that goes, but the battery factory that

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1 is what's built there is a lithium battery factory,
2 so, hopefully -- and Panasonic runs it, so there's
3 going to be demand for that. And I'm sure even with
4 Tesla's problems, it's not going to go away anytime
5 soon.

6 On top of that, we've had Apple, Google,
7 Amazon. They're all building distribution
8 centers and data centers and what have you.

9 I don't know if you've heard of Switch.
10 Switch is a huge data center facility, and they also
11 have a co-location facility, which a lot of the
12 backroom IT operations need as a co-location site,
13 so that's another big, big draw in Reno.

14 In Vegas, as you know, we got our first
15 NHL expansion franchise last year. We went all the
16 way to the Stanley Cup. And sorry to say, we lost
17 to the Washington Capitals, so hats off to you guys
18 here locally.

19 In 2020, we're expecting the Raiders to
20 move. I know Louise is sad to see them go, but
21 we're looking forward to that, so we're building
22 a new stadium for them, 65,000 square foot -- I

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1 mean, not square, occupancy stadium, practice
2 facilities, all of those that go with any NFL
3 facility that comes in, so it's driving business
4 significantly.

5 Lots of businesses are moving in,
6 ancillary businesses, not just for the
7 professional sports side, we're also seeing
8 professional business services moving in, health
9 and educational services. All of those are
10 growing, so we're expecting that the
11 diversification of the economy that has started in
12 a modest way, it's going to be a while before gaming
13 gets taken over by some of these other things,
14 because gaming is a 600-pound gorilla and it's
15 going to be a long time before gaming will be
16 supplanted by some of these other kinds of
17 businesses, but it's still a good plan to see
18 happening.

19 Our challenges, like anything else in
20 the room here today we heard about, is continuing
21 to find affordable housing. Housing is a problem
22 in Nevada. Now, the average or the median home

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1 price in southern Nevada is \$300,000 as of
2 September of this year. That's still lower than
3 what it was ten years ago.

4 When the recession started in 2005, I
5 think, inflation-adjusted that it would be
6 \$391,000, so it's still lower than that, but when
7 you think back 15-20 years ago, people moved to
8 Vegas because the cost of living was cheaper.

9 You could buy a decent home for about
10 \$150,000. It's not the case anymore. And
11 especially when you see a lot of these -- the new
12 job growth has not been in the construction as much
13 as it's been in the service businesses that don't
14 pay as much, and so it's a challenge.

15 Given the cost of building homes, as
16 we've heard from around the table, land prices in
17 Vegas have gone up from 100,000 an acre to about
18 500,000 an acre now. Labor costs have gone up,
19 because the construction labor is getting more
20 expensive, and material costs have gone up. This
21 is even before any of the tariffs that are being
22 talked about now is going to have an effect on the

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1 cost of building, so given all of that, it's going
2 to be a challenge.

3 And how we -- how we work through that
4 is yet to be seen. There's a lot of multifamily
5 housing being built, a lot of rentals. I think --
6 you go around Vegas and you see apartment complexes
7 cropping up all over the place.

8 And the reason is, number one, the
9 affordability of single-family homes is low, and
10 number two, the people who have probably had to have
11 a short sale in their history are not able to
12 qualify for a mortgage, so they're forced to rent
13 for the time being, and so apartment complexes are
14 doing well. Their vacancies are low and are doing
15 well.

16 The last thing I want to talk about
17 challenge-wise is finding skilled workers in
18 Vegas. Skilled workers, especially in the
19 construction field and even the professional side,
20 are few and far between, and that is going to
21 continue to have an impact on the way the city
22 grows, as well as in Reno.

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1 Reno is almost impossible to find good
2 people. All of the IT guys are moving in from the
3 Bay area and they're finding it hard to find
4 qualified people to staff all their functions.

5 Having said all of that, Vegas is still
6 a good proposition. It's got a good climate. It's
7 got the cost of -- cost of living index is pretty
8 reasonable. Business-friendly, so businesses do
9 want to move into Nevada. We have no personal
10 income tax, so that continues to drive the economy.

11 And last but not least, Vegas must be
12 looking good because the FDIC just recently
13 approved a charter. For the first time, a new bank
14 will be opening in the next few months in Las Vegas
15 since as far back, far back as 2010.

16 We opened in March of 2008. We're
17 going on 11 years now. We've grown about \$8
18 million in size. It's about time we got another
19 bank in town. Thank you.

20 MEMBER HANRAHAN: Good morning,
21 everyone. My name is Dave Hanrahan. I'm
22 President of Capital Bank of New Jersey. Let me

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1 start by saying, Chairman McWilliams, my
2 compliments on adding this feature to the meeting
3 agenda. I've enjoyed listening to my colleagues
4 and I'm sure the FDIC will benefit as well.

5 Although, Chad, I got to tell you,
6 following 12 intelligent esteemed colleagues is
7 leaving me, Danny, and Joe precious little really
8 to say, so perhaps next time, you could reverse the
9 order.

10 MR. DAVIS: I'm going to start the
11 other way.

12 MEMBER HANRAHAN: Yes, we appreciate
13 that.

14 Capital Bank of New Jersey is a \$500
15 million commercial bank headquartered in South
16 Jersey just southeast of Philadelphia,
17 Pennsylvania. We're privately held. Have about
18 450 stockholders. We're a state nonmember bank.

19 And our model is a classic community
20 bank model. We're a commercial lender and we
21 gather local deposits. Overall, it's a really
22 good time to be a community bank in my opinion.

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1 Asset quality is so good, probably
2 unsustainably good. Business owner and consumer
3 confidence is up, and we're the beneficiary of a
4 big income tax cut that we all got on January 1st,
5 so we're on track to post the best results we've
6 ever put up in our 11-year history.

7 That said, the topic I'll focus my
8 comments on are deposits, and many of my colleagues
9 have done that already this morning. I find myself
10 spending more time focused on the right side of my
11 balance sheet than I have in my 11-year history.

12 We all think we have loyal depositors,
13 but then that loyalty gets tested when rates go up,
14 and I'm no longer offering the best rate that they
15 can get. And we're having to spend a lot of
16 thoughtful energy on managing that in the best way,
17 and, unfortunately, saying goodbye to some
18 depositors when we just can't rationalize what
19 they're being offered elsewhere.

20 There's nothing the FDIC can do about
21 market effects on that, but I am really glad to see
22 that on today's agenda is the subject of liquidity

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1 and national rate caps. Thank you for putting that
2 on the agenda today.

3 I've heard more about national rate
4 caps from my colleagues than ever in the last nine
5 months. And I'm no mathematician, but it seems to
6 me there's something flawed about the way that
7 calculation is performed today.

8 I know that national rate caps per se
9 only apply to banks that are less than
10 well-capitalized. Nevertheless, I -- I feel like
11 it's trickling down to well-capitalized banks.
12 And I've got a safety and soundness exam starting
13 in a couple of weeks. I expect to have a lot of
14 focus on liquidity and the, the higher cost funds
15 that I might have.

16 And I've got to manage -- we've all got
17 to manage our funding sources smartly and
18 thoughtfully, but I do need to be able to pay higher
19 rates in certain cases to customers to retain those
20 clients, and it seems to me that some of the
21 national rate cap-driven math is causing those
22 good, local, loyal depositors to be looked at a

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1 little differently than I think they should be, so
2 I understand that FDIC will soon be seeking comment
3 on the national rate cap, and I will be commenting
4 on that.

5 Thank you for looking afresh at that,
6 at that topic, and I'm looking forward to this
7 afternoon's presentation on that. Thank you.

8 CHAIRMAN McWILLIAMS: See, you managed
9 to add something after 12 people.

10 (Laughter.)

11 MEMBER KELLY: I'm Danny Kelly. I'm
12 President and CEO of Hometown Bank of Alabama in
13 Oneonta, Alabama. Just we're a rural bank about
14 45 miles north of Birmingham. We have a very
15 diversified workforce.

16 And our primary customer is
17 wage-earning people, small -- individuals and
18 small businesses. We do quite a bit of real estate
19 lending in, you know, owner-occupied homes. One
20 to four carry those on our books and has been a real
21 income generator for us over the past seven, eight
22 years.

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1 Interesting story about -- I mean, I
2 hear all these stories about deposits. We did a
3 CD special for the first time in, I think, we looked
4 back, it was eight years. And the biggest issue
5 was the system, how do we do this? We forgot how
6 to do this.

7 (Laughter.)

8 MEMBER KELLY: And, then there was that
9 whole litany of discussion about how to discuss it
10 with the customer. And I said, well, you know,
11 it's a special. Everybody has one now. It's like
12 a 12-month CD. It's a special. It's what
13 everybody has.

14 So, it was really interesting to kind
15 of take a step back and say, wow, it's been this
16 long since we've had to do anything as far as
17 liquidity is concerned, because, you know, we were
18 at about 65, 68 percent loan-to-deposit. Now,
19 we're at about 83 percent.

20 We purposely let some high-cost stuff
21 run off. We didn't try to compete. I think that
22 that rag is dry now, and we're going to have to

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1 really get back in the business of raising
2 deposits.

3 We do -- I mean, we're just your, you
4 know, textbook community bank. We raise money
5 from our depositors and we do, you know,
6 occasionally use the home loan bank depending on
7 what the demand is or the need is, but other than
8 that, you know, that is our source of funding, and
9 I think that's going to be our biggest challenge
10 coming up is how to manage that right side as David
11 was talking about.

12 But we got about 44 percent of our
13 market share where it -- our county is about 50,000
14 people, so Alabama has been fairly aggressive about
15 incentivizing businesses to come there. And
16 workforce development is a big issue, and it's one
17 of those things that they spend a lot of money, you
18 know, doing that and continue to pour money into
19 that, so I think we're -- I have discussions with
20 people all the time.

21 The only thing you know about Alabama
22 is the football team or unless they drive through

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1 there on the way somewhere and that's basically it.
2 I doubt they're going to the coast today, but, you
3 know, somewhere down in that general area anyway.

4 But, anyway, I don't have a whole lot.
5 I'm with David. I'm at the end of the table, so
6 I'm going to make it real short, but, again, we --
7 our bank is close to 15 years. In fact, 10 days,
8 it'll be 15 years old, so the crisis was a lot of
9 fun, but, you know, we did learn some things from
10 it, and I appreciate the opportunity also to serve.
11 Thank you.

12 CHAIRMAN McWILLIAMS: Thank you.

13 MEMBER TURNER: Okay. Thanks, Danny.
14 And I'm actually at the very end of the table, so
15 -- and whatever there was to say, David and Danny
16 finished it up, but I'm Joe Turner. I'm CEO of
17 Great Southern Bank. We're headquartered in
18 Springfield, Missouri. We're \$4.6 billion.

19 Kind of our legacy operation has been
20 in Missouri. We have operations in Springfield
21 and Kansas City and St. Louis and then throughout
22 rural Missouri as well.

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1 We purchased five banks from the FDIC
2 during the last crisis. They had operations in Des
3 Moines, Iowa. It's been a good -- it's been good
4 for both parties. Des Moines, Iowa, Sioux City,
5 Iowa, the Quad Cities in Iowa, Twin Cities,
6 Minneapolis/St. Paul. We have loan production
7 offices in Dallas, Tulsa, Atlanta, Georgia and
8 Denver.

9 And I would echo many of the comments
10 that have been made. You know, I think the
11 economies in all those areas are strong, you know,
12 they remain strong. I would say maybe activity has
13 slowed just a bit, and so I think we're at a
14 dangerous point. Other folks have alluded to
15 this.

16 I think, you know, people are used to,
17 like John said, 15 percent growth rates, and it's
18 harder to get, and so, you know, what do you do?
19 The banking industry seems to compete on loan
20 proceeds. In other words, how much will you loan,
21 what's the price, and what's the guarantee
22 structure?

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1 And, so, I think in certain markets,
2 Minneapolis/St. Paul probably being one of them,
3 extremely aggressive there, you know, and maybe
4 some non-traditional competitors, credit union
5 competitors, and some others, but I think all our
6 markets, we're seeing a little bit more
7 competition.

8 I think, as some of the speakers have
9 alluded to, labor availability is going to be a
10 constraint on continuing economic growth. I was
11 visiting our banks in the Twin Cities about a month
12 ago, and they mentioned that a large grocery store
13 chain was looking at opening a sizeable grocery
14 store or two in kind of what they described as a
15 second-ring suburb of Minneapolis/St. Paul, so
16 relatively near to the, the central business
17 district.

18 And they concluded there's not enough
19 available workforce to make that make sense, so
20 they decided not to do that. And I think that's
21 happening elsewhere too.

22 We -- we have a pretty large industrial

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1 customer, a customer that develops industrial
2 property, and those folks have told us their
3 biggest -- the biggest thing they look at is
4 workforce availability when they're buying a
5 ground. It's not road access. It's not
6 necessarily geography. In other words, central
7 part of the U.S. or whatever, it's what's the
8 availability of qualified workforce.

9 Like everybody, our loan-to-deposit
10 ratio is over 100 percent, so I'm also encouraged
11 that we're going to be talking about, you know,
12 brokered deposits and other things. I think, you
13 know, we've had brokered deposits on our balance
14 sheet for a long time, and so just an advertisement
15 for it, I think it is a quality alternative funding
16 source that banks should be able to use.

17 You know, I realize, I think, the FDIC
18 has done a study that showed that, you know, many
19 of the banks that failed had brokered deposits, and
20 I would suspect that's true. I'm not sure there
21 was causation between having brokered deposits and
22 failure. It's more -- it's more an issue of what

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1 you do with the deposits. Whether you -- whether
2 you bring deposits in in your local market or you
3 get them from a broker, if you make bad loans with
4 them, you're going to have a problem.

5 And, you know, I just think, you know,
6 for us as we think about raising maybe \$100 million
7 in deposits, you got two ways to do that. You can
8 go -- or lots of ways to do that, but, you know,
9 you can, you can borrow money from brokers or you
10 can risk repricing your entire \$4 billion
11 portfolio, so as you raise that \$100 million, if
12 you re-price your entire portfolio, the marginal
13 cost of that is extremely high, so, you know, I'm
14 glad to see that we're going to be talking about
15 that. I think, you know, that a really even-handed
16 approach by the FDIC to brokered deposits, you
17 know, would be a very good thing.

18 Interest rate risk, I think, we're like
19 most of the industry is seeing higher beta factors.
20 It was interesting in our last ALCO meeting, we had,
21 you know, kind of an expert talking to our ALCO
22 committee, and this person said that the last time

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1 rates came up like in 2004, they rose 425 basis
2 points. Beta factors during the first 100 basis
3 points were 8 percent, during the next 100 basis
4 points were 25 percent, and during the third 100
5 basis points were about 100 percent, and, you know,
6 that's kind of what we're seeing, and, I think,
7 that's what the industry is seeing.

8 You know, we haven't had the third 100
9 basis point yet, but the first 100 was about 8
10 percent beta factor. We've had 25 or 50 since
11 then, and I think it has been about 25 percent, and
12 so, yes, I think increasing beta factors are, you
13 know, going to be a fact going forward.

14 We're starting to look at -- I mean,
15 we're asset-sensitive, which has been a good thing,
16 but, you know, we've heard many of the people say
17 the economy is going to turn, and when the economy
18 turn, rates are going to turn down, and we're
19 frankly not as well positioned for that, and so
20 we're trying to, you know, think about maybe how
21 do we take a bit of our asset sensitivity off the
22 table to better prepare for, you know, what we think

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1 inevitably will be, you know, rate declines.

2 And when rate declines happen, you
3 know, you start seeing generally a weaker economy.
4 They happen as a result of a weaker economy, so
5 you're going to see more credit costs, maybe less
6 economic activity otherwise, so you don't want to
7 have a compressed margin on top of that, so we're
8 focused on that.

9 That's all I have.

10 CHAIRMAN McWILLIAMS: Thank you.
11 This is great. Thank you. I joke that I have to
12 go around the country to solicit this type of
13 feedback, so this is remarkable that we are able
14 to get a very diverse perspective. And I know you
15 felt like you were at the end of the table, but I
16 guarantee you, this side added as much as this side,
17 so thank you very much for that.

18 MR. DAVIS: We actually have,
19 amazingly, a couple of minutes left. Usually, I'm
20 going to be the guy cutting things off, but we can
21 just go to the break, but I thought I'd give folks
22 the option first if there was any questions that

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1 folks had as they were listening to peers. If
2 there's any topic that they want to discuss, again,
3 we got a couple minutes just thought I'd give people
4 the option.

5 CHAIRMAN McWILLIAMS: I actually have
6 a question. Some of you mentioned exiting
7 mortgage originations. Can you just raise your
8 hand if that's an issue for your bank?

9 MEMBER SCULLY: We haven't exited, but
10 we've cut it by two-thirds.

11 CHAIRMAN McWILLIAMS: Okay. Okay,
12 thank you.

13 MR. DAVIS: Okay. Well, if there
14 isn't anything else, we've got a break then until
15 10:45, so feel free to grab coffee, water, make some
16 calls, check some emails and we'll meet back here
17 in about 15 minutes. Thank you.

18 (Whereupon, the above-entitled matter
19 went off the record at 10:27 a.m. and resumed at
20 10:52 a.m.)

21 MR. DAVIS: Okay, now we're going to
22 provide the committee an update on several

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1 supervisory issues. From our Division of Risk
2 Management Supervision, we have Doreen Eberley,
3 the director, Rae-Ann Miller, an associate
4 director, who oversees the risk-management policy
5 area, Ryan Billingsley, a corporate expert on
6 capital markets, and William Henley, an associate
7 director of our Information Technology Supervision
8 branch. I'll now turn the program over to Doreen.

9 MS. EBERLEY: Thanks, Chad. So, we've
10 been busy the last few months, since we last met,
11 in Risk Management Supervision, and we're going to
12 talk about a number of matters this morning that
13 we've been working on, some of them addressing
14 implementation of aspects of the Economic Growth,
15 Regulatory Reduction, and Consumer Protection Act,
16 signed in May of this year, and others that address
17 information that we've provided to the industry.

18 Rae-Ann's going to touch on the role of
19 supervisory guidance, notice of proposed
20 rulemaking on reciprocal deposits, examination
21 frequency, and retirement of a large number of
22 financial institution letters. Ryan's going to

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1 talk about the notice of proposed rulemaking,
2 relating to the definition of high-volatility
3 commercial real estate, or HVCRE, exposures. And
4 William's going to cover the issuance of two new
5 cyber challenge vignettes, as part of the FDIC's
6 technical assistance video program, as well as an
7 FFIEC resource guide. So, I'll turn it over to
8 Rae-Ann to kick us off.

9 MS. MILLER: Thanks very much. And in
10 your packets, you should have a pretty hefty stack
11 of stuff that we've been working on. So, as Doreen
12 mentioned, we've been very busy. I'll just
13 probably go in order of that stack, just to make
14 it a little easier, but really in no particular
15 order of importance.

16 They're all important, but I guess,
17 most recently, my group has worked on an
18 interagency statement that clarifies the role of
19 supervisory guidance in our examination process
20 and our supervisory process. And this was an area
21 where there has been some confusion and some
22 concerns that examiners were applying guidance as

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1 if it were a regulation, as if it were something
2 that were binding, and that's never been our policy
3 and never been our process.

4 So, you might not realize this, but in
5 July of 2016 -- some of you folks were on the
6 committee at that time -- we did, our board, issued
7 a statement to us on developing and reviewing
8 supervisory guidance that basically indicated, you
9 know, guidance is not a regulation, but is an
10 important piece of information, is an important
11 framework for risk-management practices, but is
12 not a binding document.

13 But on an interagency basis, we very
14 recently issued a very similar statement to
15 reinforce that message for the public and for
16 examiners. And it basically talks about the fact
17 that, unlike a statute, unlike a regulation, that
18 guidance is not binding, and examiners will not
19 indicate that a bank is in violation, so-called,
20 for not following a guidance document.

21 You should know as well that we have
22 been working with our examiners on training, on

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1 reinforcing this message. I personally, with my
2 section chief, have been out to every region,
3 training our commissioned examiners and
4 reinforcing that message in the earlier part of
5 this year.

6 So, should I just go through them all
7 and then hold questions? Would that make sense?
8 Okay.

9 So, the second one that I'm going to
10 talk about, we touched on a little, and I know Dave
11 is very interested in our conversation this
12 afternoon. But we issued a notice of proposed
13 rulemaking regarding the treatment of reciprocal
14 deposits. And Tiffany was interested in this, as
15 she mentioned.

16 So, we issued this NPR on September
17 12th, and basically, this is a conforming
18 regulation. There were some changes in the new
19 law. I can never remember the name of the new law,
20 so we call it S.2155.

21 And so basically, the changes we made
22 in our NPR were to conform Section 29 of the Federal

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1 Deposit Insurance Act to the new law. So, what the
2 NPR does is it basically incorporates a definition
3 from the act. And what that does, it accepts a
4 capped amount of reciprocal deposits from being
5 treated as brokered deposits for certain insured
6 depository institutions. And that cap, just as a
7 reminder, is the lesser of either 5 billion
8 dollars, or 20 percent of total liabilities. And
9 a special cap also kicks in if the institution is
10 either not well-rated or not well-capitalized.
11 And that's a little tricky, but that cap gets
12 calculated based on the average of the last four
13 quarters before the institution either became less
14 than well rated or less than well-capitalized.

15 So, basically, it's a conforming type
16 of notice. It was published in the Federal
17 Register on September 26, and the comment period
18 is open through October 26. I think more
19 interestingly, perhaps, in the NPR we announced
20 that we are going to be -- this is the first of two
21 parts of a broader rulemaking effort, where we're
22 proposing, or we're planning, rather, to seek

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1 comment on a broader range of issues later this
2 year, on the overall brokered deposit regulations.

3 I mean, as you know, the law, with
4 respect to brokered deposits was first put in place
5 in 1989. We're going to talk about a little bit
6 about it more this afternoon, but first, from the
7 last crisis in 1989, and it was amended in 1991 and
8 basically tied to the PCA, Prompt Corrective
9 Action, framework.

10 So, it's certainly been a while since
11 the law has been written. I was very interested
12 in your conversations this morning about really how
13 the deposit market has changed, and continues to
14 change. And David and I were just talking a little
15 bit about that at the break. So, very interested
16 in your thoughts on that. And we certainly
17 encourage comments on the broader rule later this
18 year.

19 So, that's reciprocals. I will move on
20 to the next one, which I believe is exam cycle. So,
21 the new law also extended the 18-month examination
22 cycle for certain institutions. And as we did the

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1 last time the law was changed, we issued an interim
2 final rule to make the law immediately -- or, the
3 law was immediately effective for one-rated
4 institutions, but to make that change immediately
5 effective for two-rated institutions, which we
6 must do via regulation.

7 So, basically, for qualifying one- and
8 two-rated institutions with assets up to 3 billion,
9 they are subject -- or, eligible for the 18-month
10 exam cycle, provided they're well-managed,
11 well-capitalized, not subject to enforcement
12 action, not subject to a change in control.

13 The interim final rule is going to
14 increase the amount of institutions eligible for
15 the cycle by about 420 institutions. So, that
16 brings the total number of eligible to 4,798. So,
17 that's the vast majority of all institutions would
18 be subject to the extended examination cycle. And
19 just as it is with the existing regulations, we
20 still have significant flexibility, for safety and
21 soundness reasons, to examine more frequently if
22 it's necessary.

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1 So even though that's the interim final
2 rule, we do accept comments on interim final rules.
3 We got one comment on the last one. It's a great
4 job, guys. Which is great. So, that's awesome.
5 So, we're accepting comments up through --

6 CHAIRMAN McWILLIAMS: We took that one
7 seriously.

8 (Laughter.)

9 MS. MILLER: Up through October 29th.
10 But we have already implemented that change in the
11 field, so maybe some of you, I heard about what your
12 asset sizes are. Maybe you've benefitted from
13 that.

14 And finally, I just wanted to touch --

15 MEMBER TURNER: Excuse me, do you
16 happen to know -- So, the rule is, if you're less
17 than 3 billion, is that right?

18 MS. MILLER: Yeah.

19 MEMBER TURNER: So, do you happen to
20 know, during the last crisis, what the dollar
21 amount of losses the insurance fund suffered from
22 that asset range? You know, institutions 0 to 3

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1 billion?

2 MS. MILLER: I do not know that number
3 off the top of my head.

4 MEMBER TURNER: I didn't think you
5 probably would.

6 MS. MILLER: They are costly, they are
7 costly.

8 MEMBER TURNER: They -- Yeah, but I'm
9 sure it was, even though there were a lot of those
10 institutions that failed, they just don't have as
11 big an impact when they do fail. So, I'm sure it
12 was relatively small, compared to the overall loss
13 that the insurance fund took.

14 MS. EBERLEY: Zero to ten was about 40
15 billion, out of the 70 billion total.

16 MEMBER TURNER: Okay.

17 MS. MILLER: Those failures can be
18 costly.

19 CHAIRMAN McWILLIAMS: So, please don't
20 fail.

21 (Laughter.)

22 MS. MILLER: Okay, the final release

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1 that we issued was we proposed to retire a pretty
2 wide swath of our financial institution letters and
3 move them to inactive. So, this kind of started,
4 this review of our financial institution letters
5 started back in March of last year. In our EGRPRA
6 report, which we briefed up to this group many
7 times, we committed to looking at our guidance
8 documents and looking for ways, even though it was
9 outside of the EGRPRA process, but looking for ways
10 to reduce burden there.

11 So, we view this look at our FILs as sort
12 of the first step in that process. So, we looked
13 at our risk-management FILs. We have other parts
14 of the agencies also issue financial institution
15 letters, but we in RMS are by far the most popular
16 users, the best customers for public affairs, if
17 you will.

18 And we identified 374, out of 664,
19 between 1995 and 2017, that we felt were either
20 outdated, or you could find the information
21 elsewhere that lives on the website. So, we have
22 proposed to retire them. And when we say retire,

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1 it doesn't that you can't find them. I mean, they
2 do still live on our website, and they'll have a
3 retired label, archived label, whatever it's
4 called.

5 So, we proposed to do that. It's
6 interesting because we did issue that for comment,
7 and we have gotten some comments, which I thought
8 we would. And oftentimes, it's from people who
9 just can't possibly live without something.

10 And so, we're trying to do a better job
11 overall in organizing our website and in
12 communicating. You may have heard the chairman
13 talk about communication and transparency is an
14 important thing. But a better way to do that so
15 people won't be so reliant on the FIL.

16 The FIL was never intended to be a
17 standalone communication or standalone document,
18 but more of an envelope to communicate various
19 things. So, we're sort of trying to break that
20 reliance factor on FILs. They were never really
21 intended to be a permanent document. So, I think
22 that is my things. And we could turn it over to

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1 Ryan, or we can ask questions.

2 MEMBER SCULLY: So, you're saying that
3 every industry has its hoarders, is that right?

4 (Laughter.)

5 MS. MILLER: You said that, Mary Ann,
6 not me.

7 (Laughter.)

8 MR. BILLINGSLEY: So, next up, Ryan
9 Billingsley.

10 MS. EBERLEY: Dave did you want to --

11 MEMBER HANRAHAN: Yeah, I do, if you
12 don't mind Ryan.

13 MR. BILLINGSLEY: Yeah, sure.

14 MEMBER HANRAHAN: Thank you.

15 Rae-Ann, a comment on the document that's out for
16 comment on reciprocal deposits. One of the
17 questions posed in there is, how should de novos
18 be treated, with respect to reciprocal deposits.
19 And even though my bank is no longer de novo, it's
20 a fresh memory, and I still have a soft spot in my
21 heart for that.

22 My understanding of the issue is, as the

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1 legislation was written, it pertains to banks not
2 well-rated. If a bank is not well-rated, that's
3 an issue for reciprocal deposits. And de novos,
4 by definition aren't well-rated because of their
5 newness. I'll use a line that I hate when my kids
6 use on me. That doesn't seem fair.

7 The de novos have done nothing to earn
8 a not-well-rated status, and reciprocal deposits
9 take just as long to cultivate and foster with
10 customers as any other vanilla deposit account.
11 De novos have sometimes an added burden of
12 convincing their market that this brand new bank
13 is a safe place to put their money. So, the
14 reciprocal aspect could be very valuable to a de
15 novo in its early days, and it just doesn't seem
16 right to me that a de novo would be ineligible to
17 use reciprocal deposits, simply by virtue of its
18 newness.

19 So, I will be submitting a comment
20 letter -- and I'll say it better than I just did
21 -- in that regard before the October 26th deadline.

22 MS. MILLER: We look forward to that

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1 comment letter, David. But I will say that --

2 CHAIRMAN McWILLIAMS: I think you just
3 need to block David's address, because he's
4 submitting a comment letter on everything.

5 (Laughter.)

6 CHAIRMAN McWILLIAMS: No, we encourage
7 you to. Please do. It would be immensely
8 valuable to us if you could provide comments on
9 this.

10 MS. MILLER: And just to correct
11 something that you said, it's not that they
12 wouldn't be able to use them. They would be able
13 to use them, but they would need to report them as
14 reciprocal. I mean that's -- As brokered, rather.
15 Yeah, as brokered deposits. So, that's the issue.

16 But that's a very good point, and I
17 don't know that the drafters had thought about --

18 MEMBER HANRAHAN: And they're probably
19 not allowed, under their new business plan, to use
20 brokered deposits.

21 MS. MILLER: That, I don't know. It
22 depends.

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1 MS. EBERLEY: Yeah, de novos typically
2 have some amount of brokered deposits in their
3 business plan.

4 MS. MILLER: I guess it depends on that
5 thing. But you made me think of another thing too,
6 David. One of the other aspects of this law is that
7 the reciprocals can't come through a third party,
8 so they have to be that cultivated with --

9 MEMBER HANRAHAN: True, right. That
10 makes sense.

11 MEMBER HARTINGS: Rae-Ann, if I could
12 just make a comment about the exam cycle. And this
13 is kind of the thought process. You know, you talk
14 about I think 420 banks now will fall underneath
15 the new exam 3 billion dollar cycle. You know, I
16 hate to say it's a win-win, but even if you look
17 to losses that we've sustained, one thing it gives
18 you is it allows you to concentrate your effort on
19 those banks that are less than one- and two-rated,
20 which is what you need to do.

21 And I'm a 500 million dollar bank, and
22 I'm already looking at a billion or a billion and

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1 a half, so does that make my strategic planning a
2 little bit better going down the road? And what
3 I mean by that is, if you can keep regulatory
4 thoughts in long-term planning, I'm a 115-year-old
5 bank. All of our banks here have been around a long
6 time. We talked about succession planning and
7 getting people on-site, and the right workers.

8 About eight years ago, we started a
9 management training program because we were having
10 the same issue. I didn't benefit from that for the
11 first five years. Now, the last two-three years,
12 it's starting to benefit. And I think this exam
13 cycle is the same way. We see our banks getting
14 larger, so let's build a plan that's good for you,
15 good for our oversight, but also doesn't restrain
16 that growth of community banking, because I think
17 as you look forward and say, well, we'll do this,
18 but what happens if we get a little bigger?

19 And so, I mean, I think it's great that
20 you're expanding that, but kind of think of that
21 thought process. It's, what will that do for us
22 five years from now or ten years from now, not what

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1 will it do for us today. Because, unfortunately,
2 a lot of our regulation is reactive, and I think
3 that planning is what -- I think everybody around
4 this table sits and does a great amount of planning,
5 and they don't look out next year, they look out
6 five years or ten years. So, I think that's a real
7 positive for everyone.

8 CHAIRMAN McWILLIAMS: Thank you.

9 Before we move to Ryan, Mark, will you
10 just give us the number of the consumer FILs we're
11 looking to retire, as well.

12 MR. PEARCE: Sure, I can do that from
13 here. You all can hear me. So, we have somewhere
14 in the neighborhood of a hundred and
15 seventy-something FILs on the consumer side. And
16 we think we'll be able to retire somewhere in the
17 neighborhood of 112, I think is the number. So,
18 about 63 percent of the FILs related to consumers
19 will be inactive as a result of this process.

20 CHAIRMAN McWILLIAMS: Thank you.

21 MS. MILLER: One more correction
22 before we move on. It's not that de novos are not

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1 well-rated, they are not --

2 MEMBER HANRAHAN: Apparently I made a
3 lot of wrong comments.

4 (Laughter.)

5 MEMBER HANRAHAN: Go ahead, pile on,
6 Rae-Ann.

7 MR. BILLINGSLEY: Sorry to cut you off,
8 I was so excited to talk about HVCRE.

9 So, why don't we go there? So, the last
10 time we were together, we talked a little bit about
11 the capital aspects of S.2155, and I wanted to give
12 you an update on what we had done on HVCRE. So,
13 it'll be very brief. I'm happy to take questions.

14 We issued a notice of proposed
15 rulemaking with the Fed and OCC on September 18th.
16 The rulemaking really only does two broad things.
17 Number one, it just aligns the definition of HVCRE,
18 or High-Volatility Commercial Real Estate, in our
19 capital rules with that that's in the statute.
20 That's pretty straightforward.

21 And number two, the reason it's a
22 proposal is that we want to get feedback on that

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1 definition, to sort of do what we can do to make
2 it clear. So, if there's areas of that definition
3 that need additional clarity, we want to hear from
4 you so we can get it right.

5 One of the things that we had a problem
6 with, with the HVCRE definition in the old
7 regulation, was this inconsistent application
8 idea, right? So, I think that that's the aspect
9 of this I would focus your attention on.

10 In the meantime, so while we work
11 through the NPR phase and collect comments -- by
12 the way, comments are due on that proposal on
13 November 27th. While we work through that
14 process, you are permitted to report HVCRE on your
15 Call Reports, using the statutory definition. So,
16 don't feel as if you have to use the reg definition.
17 If you want to use the statutory definition, please
18 do.

19 It's a best-efforts basis. We realize
20 that, as you collect information on these loans,
21 that might change how you categorize them in a
22 future period. That's okay. We're not going to

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1 ask you to refile old Call Reports because you have
2 new information in the future.

3 So, that's something I wanted to
4 definitely mention, as I'm not sure a lot of
5 institutions are aware of that. I went through
6 some of the key differences of the statutory
7 definition last time we were here, so I won't really
8 do that. But I will say that the construct of the
9 definition is largely similar to what it was in the
10 old regulation.

11 The scope is slightly changed, and some
12 of the exemptions, how you can classify a loan as
13 not HVCRE are changed. So, if you're a bank that
14 does ADC lending, I would definitely focus on that.
15 It might behoove you to pay attention to that, but
16 I won't go into the gnarly details of that
17 definition. But I'm happy to take questions on
18 that and on any other capital issue.

19 MEMBER SCULLY: So, Ryan, I have a
20 question that's come up recently. And you've just
21 alluded to the ADC lending, and that is that there
22 has been some discussion, and we haven't been able

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1 to get clarification as to whether this is true or
2 not, that 1 to 4 family now might come under the
3 umbrella of the HVCRE, if there's a certain number
4 of lots available.

5 And my reading of that is, no, they're
6 just clarifying that 1 to 4 is 1 to 4, not five,
7 but some people are interpreting that to say, if
8 it's a larger subdivision, if it's more than five.
9 And then the question is it more than five spec,
10 is it more than five in total? So, maybe the
11 general question would be, to your point about look
12 at ADC, does some 1 to 4 now come under the umbrella
13 of HVCRE?

14 MR. BILLINGSLEY: So, under the old
15 definition -- It's a great question -- under the
16 old definition, it would not have. Under the
17 statutory definition, the definition just says, 1
18 to 4 family residential real estate is excluded.
19 Well, the question is, "What does that mean?" So,
20 that's the purpose of the proposal is to get
21 feedback from you all on, is that consistent with
22 how you report on the Call Report? How do you use

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1 it in your Real Estate Lending Guidelines, your
2 policies and procedures?

3 MEMBER SCULLY: We look at the
4 dwelling. We don't look at how many dwellings
5 there are. We just look at the dwelling.

6 MR. BILLINGSLEY: What I would point
7 you to is, the 1 to 4 is really getting at, is it
8 single-family or multifamily, right? So, if you
9 have an apartment building that has five or more
10 units, that's in the multifamily space, right? If
11 you have single-family dwellings, that's in the 1
12 to 4 family space.

13 So, a lot development loans to
14 construct a small subdivision is likely going to
15 be excluded in the 1 to 4 family exception. Again,
16 the purpose of the rule is to make sure that we get
17 feedback from you on how you're going to categorize
18 that and what the risks are, and to make sure that
19 how you report that to the system with other
20 regulations as well. Consistency with other
21 regulations is kind of a big deal with this one.
22 Is that helpful?

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1 MEMBER SCULLY: Yes.

2 MR. BILLINGSLEY: Okay.

3 CHAIRMAN McWILLIAMS: I think David
4 may have to submit one more comment on this.

5 (Laughter.)

6 MR. HENLEY: Well, good morning. My
7 name is William Henley. And thank you for the
8 opportunity to inform you about two coming
9 attractions from RMS's Operation Risk Group. So,
10 the first update is to the FDIC Cyber Challenge,
11 a community bank cyber exercise.

12 So, practicing your response in the
13 face of an operational incident is key to an
14 organization's resiliency, should an incident
15 actually occur. Post-incident critiques often
16 confirm that experience gained during exercises
17 provides the best way to prepare organizations to
18 respond effectively to an emergency.

19 Effective exercises are designed to
20 engage team members so that they can collaborate
21 in the management of a response to a hypothetical,
22 yet possible, incident. Exercises enhance

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1 knowledge of plans, allow members to improve their
2 own performance, and identify opportunities to
3 improve capabilities.

4 In 2014, the FDIC published for the
5 first time four scenarios that a community bank
6 could use to exercise their business continuity
7 plans. We added three more scenarios in 2015, and
8 this month, we will release an additional two
9 scenarios, bringing the number to nine scenarios
10 that are available.

11 Each scenario is supported by
12 guidelines for conducting an exercise, a video that
13 walks through the scenario with actors, and
14 challenge materials that describe the scenario and
15 include questions that can be used to think through
16 how your bank would react in the scenario.

17 Just briefly, I'll go through the
18 scenarios that are available today, the first seven
19 that were released. The first is an
20 item-processing failure. A new item-processing
21 service provider cannot process the volume of
22 transactions generated by the bank.

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1 Customer account takeover is the second
2 scenario. A corporate customer reports
3 unauthorized withdrawals on its account.

4 The third is a phishing scam. Bank
5 staff receive a phishing email that appears to have
6 been sent by the institution's president and causes
7 disruptive malware to be introduced to the bank
8 systems.

9 The fourth is a technology service
10 provider problem. It is occurring as a result of
11 a system update.

12 The fifth is DDOS, or a Distributed
13 Denial of Service attack. The bank IT manager
14 investigates a possible DDOS attack and discovers
15 a second attack that steals data from the
16 institution.

17 The sixth is ATM malware. ATM malware
18 reveals deficiencies in the bank's service
19 provider contract.

20 And the seventh is ransomware. A
21 cyber-attack has taken place, and important files
22 are being held for ransom.

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1 So, all of the scenarios that are
2 currently available are based on actual incidents.
3 The two new scenarios are natural disaster, a
4 flood. Operational problems ensue after the bank
5 status center and their telecom provider's
6 operations are flooded.

7 And a supply chain incident. A
8 third-party software update infects the bank's
9 systems, disrupting core processing, and breaches
10 sensitive data.

11 So, by the descriptions that are
12 provided, we see that these are current and
13 applicable to the environment today. We chose to
14 add these two new scenarios because recent
15 incidents that remind us of the higher probability
16 of these types of incidents are actually occurring.

17 And the first scenarios are currently
18 available on our public website, fdic.gov, and the
19 two new scenarios will be added shortly. They
20 should be out this month. And we hope that these
21 resources are helpful to community banks, as you
22 test your business continuity plans. And we

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1 continue to welcome your feedback on these
2 scenarios.

3 The second release is October, for the
4 last fifteen years, has been designated as National
5 Cybersecurity Awareness Month, which is an annual
6 initiative to raise awareness about the importance
7 of cybersecurity. The Federal Financial
8 Institution Examination Council, or FFIEC, is
9 hosting a cybersecurity webinar on October 31st.
10 And we're also publishing a new cybersecurity
11 resources guide for financial institutions.

12 Webinar registration materials will be
13 sent to you via FDIC connect, and they should be
14 out shortly for registration. So, it's an
15 industry-only, or institution-only webinar.

16 The webinar will review the programs
17 and initiatives included in the guide, which are
18 designed to help organizations meet their
19 cybersecurity control objectives.

20 The resources are divided into four
21 types: assessments, exercises, information
22 sharing, and response and reporting. The first

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1 page of the guide identifies the 16 cybersecurity
2 resources and whether they're free, or a fee
3 service, or a combination thereof. And the
4 subsequent pages provide an overview of the
5 services, as well as information on how to
6 investigate further.

7 The intent of this guide is to
8 centralize information about a set of resources
9 currently available from government and the
10 private sector, that can help improve the
11 resilience of the sector. We often hear from
12 community banks that it's hard to know where to
13 start in assessing the myriad of cybersecurity
14 resources available, and we hope that this guide
15 reduces burden on institutions that would
16 otherwise have to complete this research
17 individually. Thanks again for the time to update
18 you on these initiatives.

19 MEMBER SHETTLESWORTH: Concerning
20 phishing attacks, that's a real issue that we face
21 every day. My question is, when it comes to the
22 FDIC, have you all ever considered what to do with

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1 the information whenever someone is emailing us
2 trying to come off as a customer of ours, saying,
3 please send a wire to X bank somewhere else?

4 Most of the time, we'll delete those
5 emails. Sometimes we'll play along and say,
6 please send us your wiring information. And so we
7 have the account information, the fraudulent
8 account information, at a legitimate institution.
9 It's usually a larger institution or an online
10 bank.

11 But is there anything that we can do?
12 Because that's the point of fraud, through that
13 account, and I'm just curious, is there any type
14 of reporting we can do or FDIC can facilitate with?
15 Because until you cut it off there, at the new
16 account opening place, you'll never even make a
17 dent in this process. I'm just curious if that's
18 ever come up.

19 MR. HENLEY: Yes, so, questions like
20 that have come up. In our last alerts on security
21 alerts, one of the things that we have encouraged
22 is participation in information-sharing groups

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1 like FS-ISAC. And I know that they compile that
2 information, and I think that the public-private
3 partnership and the provision of FS-ISAC is really
4 where we would encourage you to join and to share
5 that information there, because they do provide
6 aggregated information on those types of threats
7 and do a good job of pushing out to members about
8 those threats.

9 MEMBER SHETTLESWORTH: Okay.

10 MEMBER HARTINGS: Have you seen --
11 we've seen in our area, masking phone numbers.
12 Basically, the technology today, it's kind of like
13 the good old-fashioned way to defraud. They are
14 able to make it look like our bank's phone number,
15 make a call to customers. And I mean, we're seeing
16 that happen a lot in our areas, and now it's
17 starting to move down to texting. Have you heard
18 much of that? We talked to the phone companies.
19 That's a technology that's available out there.
20 It doesn't seem like anyone can do anything about
21 it. But have you heard about that? It's a little
22 bit different than phishing, but it's done over

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1 your phones. Have you heard much feedback from the
2 banks on those issues?

3 MR. HENLEY: You know, we were talking
4 this morning over breakfast that there's no end to
5 these schemes that criminals come up with, because
6 it's important to them, right? It's part of their
7 business model. And so, with that, you know, we've
8 received calls like that, even here within the
9 FDIC, that type of phone masking. And yes, it's
10 just another attack or attack vector that the
11 criminals are using.

12 CHAIRMAN McWILLIAMS: I got one of
13 those on my work phone, yes.

14 MEMBER DONNELLY: William, just on
15 those exercises, you said there's going to be seven
16 of them. And we participate in the FS-ISAC payment
17 attacks exercises. It's a couple-day event and
18 two or three hours a day. What do you expect the
19 time to be to run through one of your exercises?
20 Because it is a cost. Absolutely good stuff, but
21 you've still got to apply a cost to that. So, do
22 you have an expectation of time it would take to

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1 go through those?

2 MR. HENLEY: That's an excellent
3 question. So, each of the vignettes, they start
4 off with the video, and the videos that are being
5 released, and the seven that are available and the
6 two that are being released, I believe are all under
7 five minutes. I think that numbers 8 and 9 are like
8 three and a half minutes each.

9 And then, they come with a set of
10 instructions, or instruction cards, that kind of
11 walk you through a facilitated discussion. So, I
12 think that an institution could set aside a
13 reasonable period of time, you know, an hour or two,
14 or maybe even less, because like I said, the
15 scenario is presented through the video in a
16 three-and-half-minute segment. It's got a set of
17 questions that help the staff to walk through it.
18 So, it's not intended to be a long investment of
19 time.

20 MEMBER DONNELLY: No, I'm just looking
21 for an idea, because I totally agree with the
22 exercises, because they do open up and enlighten

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1 what you need to do in your own shop, and just kind
2 of getting an estimate of time before we get
3 started. I'd hate to get into something and find
4 that one take three weeks or a month to do, and then
5 say oh. So, thank you. That's exactly what I was
6 looking for.

7 MEMBER HARTINGS: We've done these,
8 and we have about twelve to fourteen individuals
9 in a room, I'd say. You can do two of them in about
10 an hour, a little over an hour. That's about what
11 we planned for.

12 MEMBER DONNELLY: Thank you.

13 MEMBER K. KELLY: William, I just want
14 to commend you. This is a very important topic,
15 and it's one that, to be perfectly honest, I think
16 for the CEOs up here, it could keep us up at night,
17 because it's the new form of robbery in this
18 industry. And so, I want to commend you for it.
19 We're going to take it to heart and use the nine
20 that you've put before us.

21 My question would be, is there a -- I
22 heard the acronym used for the group that's focused

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1 on this, but my concern on a broader level would
2 be how do we transfer information without creating
3 a panic when something new happens? And I don't
4 know the answer to that, and maybe I'm just not
5 aware, but, you know, it's an arms race out there,
6 as you and I talked about this morning. The guys
7 are getting just as smart as we are at playing
8 defense on it, and my point is, every time something
9 new happens, is there a way to communicate without
10 creating paranoia and a crisis, such that people
11 can play defense on some of those new methods that
12 they're using?

13 MR. HENLEY: Certainly. And thank you
14 for the question. And I forgot to mention that
15 acronym. You know, here in D.C., we speak only in
16 acronyms. The rest of the world does not.

17 So, the FS-ISAC, that's the Financial
18 Services Information Sharing and Analysis Center.
19 And so, it was the product of a presidential
20 directive that set up the public-private
21 partnerships between the 18 critical
22 infrastructure sectors. And so, each sector has

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1 an information sharing and analysis center. And
2 so, that member-driven organization that reporting
3 into that organization, into FS-ISAC, is on a
4 noncompetitive basis. It's for analysis for the
5 sector. So, that would be the site or the
6 destination that I would encourage the members to
7 do, is to work with FS-ISAC.

8 MEMBER K. KELLY: Okay, great.
9 Thanks.

10 MEMBER TOLOMER: I commend your
11 efforts, but I would also suggest -- I know we do
12 it. I'm sure many of you do as well -- is there
13 are programs that you can purchase, where you can
14 periodically test phishing for your entire
15 employee base. And what we found was, the first
16 go round, we had four or five people that didn't
17 make it. And now, it's very unusual if somebody
18 clicks onto the site. But we make it part of their
19 job responsibilities, and so, if somebody fails
20 twice, they end up having a conversation, being
21 verbally warned for their employment, and
22 continued means that they'll leave.

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1 This is the number one way a bank can
2 protect itself against phishing, and that's the
3 number one thing that happens for cybersecurity.
4 So, it's a very serious matter, and there are
5 programs where you can test yourself, and you'd be
6 amazed that from time to time, people click on a
7 \$5 coupon or a \$10 coupon just because they can't
8 help themselves. But they begin to learn it's not
9 to be trifled with.

10 And so, it's the best we way we know how,
11 so I think it's a great way to do this, but I would
12 encourage people to purchase a program that you can
13 test your employees on all the time on an ongoing
14 basis. I think that you were talking about that,
15 Kenneth.

16 MEMBER K. KELLY: Right, and John,
17 we've used some of that. In fact, we've seen, back
18 to the sophistication, where now, there's the
19 effort that they would use,
20 kkelleyfirstindependence@gmail.com. And so, my
21 point is, the nuances are increasing with the
22 ability to try to figure out how to penetrate. And

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1 so, for someone who says, oh, that's Kenneth, he's
2 sending me an email. But really it's not, it's
3 kennethkelleyfirstindependence@gmail.com.

4 My only point is, as leaders up here
5 around this table, we have to figure out how do we
6 communicate in such a way that if I see that, all
7 of us should see that, so that we can play defense
8 against it, versus having to figure it out on our
9 own. Because by that time, it could potentially
10 be a loss for one of our institutions. That's the
11 only point that I wanted to make on that.

12 MEMBER EMMONS: I would just, as a
13 point of interest, I would offer that we have a very
14 strong state banking association, and if there's
15 one time when we stop acting as competitors, it's
16 when we have an attack that's perpetrated on one
17 of the banks. And the communications that takes
18 place at the committee level -- so, they have an
19 info security committee or a security committee.
20 And when an attack happens, it's often
21 geographical, and so there's a communications that
22 goes through the state association that tends to

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1 be very helpful. So, I think that's one of the
2 areas where you can look for some help.

3 MR. HENLEY: Yeah, so, the State
4 Liaison Committee and the Conference of State Bank
5 Supervisors are members of the FFIEC. We work
6 closely with the representatives from those
7 organizations. And in the face of incidents or
8 disasters in the past, we've had many lessons
9 learned that we've tried to incorporate, just for
10 example, with incidents that happened at service
11 providers, that now, with the speed of technology,
12 and being able to move across geographic
13 boundaries, that we formerly would only contact
14 those commissioners for the state or states that
15 were affected by an event.

16 But after lessons learned, we were able
17 to -- we saw that was a blind spot, that we needed
18 to work with commissioners in banking departments
19 more reflective of the customer base, as opposed
20 to the geographic impact. And so, we have a strong
21 partnership with the state banking departments in
22 this area, particularly through those two

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1 organizations that I mentioned.

2 MEMBER PAINE: I do think that, when we
3 talk about disruption, a lot of people focus on the
4 fintechs, but really, if you're talking about
5 spoofing, or malware, or phishing, or -- we had this
6 thing happen to us, spambot. That's crazy. It
7 was just, we had our executive secretary just
8 flooded with a thousand emails in fifteen minutes.
9 And this kind of disruption -- and it's debit card
10 fraud, and it's ACH fraud, and internet banking
11 fraud, and it's not just key loggers anymore. It's
12 so much that I think that the disruption portion
13 of it, the automation has made our life simple, and
14 the disruption has made it twice as hard.

15 So, not only the cost, because we can't,
16 as a 140 million dollar bank in rural Minnesota,
17 hire an IT person that's going to stay more than
18 a year or two before they want to go to a metro area
19 -- it has created financial and at times emotional,
20 because these are customers. And it's not our
21 employees necessarily. We do the social
22 engineering like we're supposed to do. But it's

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1 not our employees, it's our customers. It's our
2 customers that went on their online banking, and
3 went through the two layers of security because
4 their CEO sent them an email to wire funds. And
5 just because we are a 140 million dollar bank, when
6 that wire came through, and we went through and
7 verified, with that customer, hey, did you actually
8 send this wire? They said yes. And we went
9 through our second check internally, manually, and
10 we said, they don't -- this is abnormal. So, we
11 called the president and stopped a \$500,000 wire
12 from going out, because we know our customers.

13 It's not necessarily just us. It's our
14 customers. So, we try to educate our customers,
15 especially the ones with the cash management, we
16 sit down with them on their annual review, when
17 we're going through their contracts. But if some
18 way, the regulators, in a reasonable form, could
19 help assist us to say, these are things that you're
20 liable for -- because guess what. They're not
21 going to take the loss, we are.

22 We had a \$13,000 loss on an ACH file that

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1 was somebody used a public computer in Vegas, in
2 Caesar's, signed onto their commercial banking.
3 And guess what, they got hacked. So, we ended up
4 taking the loss on that. Even though in the
5 contract it says we won't, you can't do that in a
6 small town, for a small business.

7 So, if we can get some assistance, that
8 would be so helpful because there's a liability
9 aspect of that. We're not IT professionals.
10 Neither are you, and I get that. But if we can
11 somehow team up together to get a be safe, you know,
12 bullet-pointed, something that we can either add
13 to the contract, or put in our annual training, or
14 something like that, that would be very helpful for
15 us because, again, our number one risk is our
16 customer.

17 MS. EBERLEY: We do have, on our
18 website, pamphlets that you can distribute to your
19 customers. We can send around the link.

20 MEMBER PAINE: That would be great.

21 MS. EBERLEY: They're graphics-ready.
22 You just download and print. One designed for

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1 retail customers, one for business customers.

2 MEMBER PAINE: That'd be great.

3 MS. EBERLEY: And we also produced an
4 issue of our consumer news that was specifically
5 focused to cybersecurity hygiene tips and tricks
6 for customers of banks. So, we'll send links to
7 both of those to all of you.

8 MEMBER PAINE: That'd be great.
9 Thanks.

10 MS. EBERLEY: Sure.

11 MR. DAVIS: Anything else on this
12 topic?

13 CHAIRMAN McWILLIAMS: You had
14 something.

15 MEMBER WALKER: No, I was just going to
16 say, add, that it's also reputational, because this
17 text alert thing, in a rural community is very
18 impactful because you tend to be the only bank
19 around. So, we end up spending all of our time --
20 The message went out, and it said, your debit card
21 transaction at First Northern Bank has been
22 fraudulent, please click here. And so, what

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1 happens is you're flooded with calls from customers
2 and noncustomers, because they're picking out a
3 whole range of area code and just sending it out,
4 thinking that most of the customers probably bank
5 there. So, it becomes -- you have noncustomers
6 calling as well, and it's just, as you said, a
7 disruption and difficult to deal with when you
8 don't expect it, and you're just sitting there
9 going about your normal day, and then all of a
10 sudden, you get all these calls from customers and
11 noncustomers.

12 MR. DAVIS: Okay. We can move on to
13 our next panel then. We'll now have an update from
14 Anthony Lowe, the FDIC's ombudsman. He's going to
15 talk about a proposed annual report from his
16 office.

17 MR. LOWE: Good morning. So, when we
18 met back in July, I provided a brief overview of
19 the Office of the Ombudsman, talked a little bit
20 about our strategies, what we do on a daily basis,
21 some of the major tenets of the office, the types
22 and methods of contacts that we have, and

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1 frequently-reported areas of concern from the
2 industry.

3 And what I'd like to do today is to
4 discuss a method of broadening the awareness of the
5 Ombudsman Office, which is, I think, a very
6 important goal, especially when you consider some
7 of the comments that our chairman has made
8 recently, in congressional testimony, and some of
9 her public statements.

10 I will want to get some input from all
11 of you as we go through this brief discussion about
12 the proposed annual report that we have presented
13 to you, and get some feedback on you, with regard
14 to the comments that are in there, the format, and
15 why you think it is important.

16 Why do we think it's important to have
17 an annual report? Well, just a little bit of
18 perspective, from 2004 through early 2014 we did
19 issue periodic reports on the industry to our
20 representatives. It provided some general
21 information, a broad overview of questions that had
22 been presented to the office, as well as some

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1 limited elements of raw data on the number, type,
2 and trends of contacts with the industry. And as
3 I alluded to earlier, as you're likely aware from
4 reading or seeing the testimony of Chairman
5 McWilliams recently -- and shame on you if you did
6 not see the testimony.

7 CHAIRMAN MCWILLIAMS: Thank you.

8 (Laughter.)

9 MR. LOWE: The FDIC is pursuing an
10 important agenda that promotes trust through
11 transparency, an initiative that aims to expand
12 transparency relative to FDIC operations. My
13 office, in trying to commit to this initiative, is
14 seeking to identify meaningful channels to
15 communicate the services and activities that we
16 provide. And it's our goal that this annual report
17 will complement agency-wide efforts in this
18 regard.

19 We've done a little bit of research in
20 this regard, and we determined that there's close
21 to 150 federal ombudsman offices around the
22 country, with 44 different government agencies.

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1 Of these, the FIRREAs, the bank FIRREAs, the OCC,
2 the FRB, NCUA, all provide some type of an annual
3 report.

4 Right now, the only agencies that
5 provide a separate annual report are the Bureau of
6 Consumer Financial Protection and the OCC. The
7 NCUA does not provide a separate annual report.
8 The FRB is in the process of developing a report.
9 They plan to have it issued by the end of this year
10 or early 2019.

11 There are some other reports that are
12 out there of course, you know, from other agencies,
13 and they do kind of run the gamut. Some of them
14 are all narrative, some of them are nothing but
15 data, a lot of dashboard approaches. Some of them
16 do include trend analysis, and some are nothing
17 more than talking about the responsibilities of the
18 office.

19 So, the report that we provided to you
20 in the materials for this meeting, if you thumb
21 through it, it just -- just to tell you what's in
22 our report right now, it includes a general

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1 description of the office, provides some detailed
2 information on totals and trends, relative to
3 contacts from the industry. It talks a little bit
4 about inquiries and complaints that do come in, the
5 sources of those complaints. And it also talks
6 about the common discussion themes, concerns that
7 are raised by stakeholders, that being the bankers,
8 the general public to some degree, the trade
9 associations, and, you know, the other regulatory
10 agencies.

11 So, what I'd like to do is ask you,
12 generally, four questions about the report. First
13 off, do you think an annual report would be of value
14 to you and to the industry? What do you like or
15 dislike about the proposed format of the report?
16 Is the information that's presented of sufficient
17 detail, or is more detailed information needed?
18 As a stakeholder, is there anything not included
19 in this report that you would like to see? And any
20 thoughts on excluding any information that's
21 currently proposed?

22 So, I will stop there and again just

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1 open it up for your feedback, your comments, your
2 questions.

3 CHAIRMAN McWILLIAMS: I just want to
4 make sure everybody has a copy of the report.

5 MEMBER WILLIAMS: Just a comment on it,
6 I think it's good, I think there's a lot of good
7 information in there. My only question though is
8 the completeness of it, because the ombudsman is
9 a resource that we can certainly go through, but
10 the other resource is directly to the regional FDIC
11 person -- if I have an issue, I call Kathy Moe, and
12 we tend to talk about it. And periodically, that
13 can be information that would be on the report, but
14 isn't because we have that relationship where you
15 can have a direct conversation. So, I don't know
16 if it provides you the completeness of the data
17 you're looking for, or even if that matters.

18 CHAIRMAN McWILLIAMS: Yeah, and
19 Anthony knows this, we're looking at our ombudsman
20 process. And exactly for that reason, some of the
21 agencies have the informal dispute resolution, and
22 some have informal and formal. So, we're looking

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1 at all of that, just to make sure we have a
2 comprehensive picture of how we handle this, and
3 that there's a real channel for banks to challenge
4 whatever they want to challenge, and for us to be
5 responsive to that.

6 MEMBER K. KELLY: I'd like to comment
7 on that. A couple of things, one, let me commend
8 you for the report. I think there is a need for
9 it. It helps to communicate what the ombudsman
10 role is and how it could work for our institutions.
11 I would tell you, for maybe the CEOs around this
12 table in general, we probably have the personality
13 to have a high relationship with the FDIC at the
14 right levels. But I see it from another
15 perspective, which is, there are institutions that
16 want to be able to ask and probe in the right way.
17 And the ombudsman role, from my perspective, is
18 duly noted and needed to do that.

19 And so, I can tell you, from having
20 dealt with several institutions that -- in
21 particular, say, minority institutions -- having
22 an ombudsman allows us to really kind of probe in

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1 a way that feels a little bit safer than normal,
2 versus having to get hit over the head, because once
3 you have that direct conversation, the
4 confidentiality and how it's dealt with is just
5 completely different.

6 And so, my point Chairlady McWilliams,
7 is that there is definitely a need for this role,
8 and I am in full support of it. I would say, can
9 we continue to build out what this report
10 represents - will help communicate the role and
11 responsibility in a way that could be more
12 effective.

13 MR. LOWE: And that's definitely one of
14 the purposes of this report. Because when I do
15 have my regional folks going out on a weekly basis
16 visiting individual banks, I'm surprised when they
17 send their weekly reports in to me, where they say,
18 this is the first visit that we've had, and the bank
19 was not aware of the services and assistance that
20 the ombudsman can provide. So, that's part of the
21 awareness project that we've been focusing on for
22 the last year and a half, and plan to continue doing

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1 into 2019, 2020. And that's part of why this
2 report, I think, is important.

3 MEMBER MENON: Is there a process where
4 there's feedback after you talk to the ombudsperson
5 about some issue or something? I just wanted to
6 ask that because we did this several years ago and
7 never heard back from the ombudsperson. So, maybe
8 things have changed over the years, I can talk to
9 you about that in private. But you know,
10 basically, it just died. We never got any
11 feedback.

12 MR. LOWE: You know, generally, if a
13 banker or a stakeholder brings an issue to us that
14 they would like for us to do some kind of research
15 on, if it's in regard to, you know, definitions of
16 a rating, or, you know, what the general process
17 is with an application, we'll have that discussion
18 and try and make sure that we conclude that matter.

19 Sometimes, there will be some ongoing
20 issues that the banker will inquire about. And we
21 do try to do go back and close those issues out at
22 some point in time. You know, sometimes there will

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1 be some open-ended items that we just can't get to
2 a full conclusion. But you know, if it is an open
3 item, we will make sure -- we try to make sure --
4 that the banker or the stakeholder knows we're
5 continuing to review this matter. Or if we need
6 some additional information, we'll let you know
7 that also.

8 CHAIRMAN McWILLIAMS: Arvind, I'm
9 curious in your feedback, so we can talk after this.

10 MEMBER MENON: Again, it goes back
11 several years.

12 CHAIRMAN McWILLIAMS: Sure, sure, no,
13 not a problem. And even if it's anecdotal, it's
14 fine. Please understand, the role of the
15 ombudsman is very important to us because it's a
16 channel that needs to be utilized. So, Ken, if you
17 have some suggestions on how we can improve it, or
18 anybody else, please give us those suggestions,
19 either by a formal letter -- comment letter -- or
20 just send us an email. But we want to make this
21 position -- Anthony's fully committed -- we want
22 to make this position as robust as possible, and

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1 viable. So, part of the outreach is exactly that,
2 how can we can we get to a place where banks are
3 comfortable reaching out and expect some kind of
4 a resolution and feedback. So, we need to come
5 full circle on this.

6 MR. LOWE: And if I can just add one
7 other comment, you know, the comments that we get,
8 especially when we have meetings with bankers, that
9 information is confidential. It's not going to be
10 shared with any of the operating divisions, or
11 anyone outside of the Ombudsman Office, with the
12 exception of possibly the Chairman's Office, if we
13 think there's an issue that needs to be addressed
14 or brought to her attention. So, anyone that
15 contacts our office should be very comfortable with
16 sharing any information and a lot of candor with
17 us, because, again, it is again maintained in a
18 confidential manner.

19 MEMBER DONNELLY: Anthony?

20 MR. LOWE: Yes, sir?

21 MEMBER DONNELLY: Just one general
22 comment on the report. You know, if you look at

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1 the topics and the different things -- and I know
2 it's a fine line between not enough information and
3 too much information, and protection of
4 confidentiality. But, just a comment,
5 examination issues is pretty broad. Is there any
6 way to layer in general topics? Because somebody
7 may see that, hey, that's exactly what's happened
8 to me, when examination issues, to all of us around
9 here, are -- you would have 15 or 20 different
10 comments. What does that mean? And I know you
11 can't go and write 25 pages per incident, but just
12 a way to maybe define -- That would be a suggestion.

13 MR. LOWE: Okay, great.

14 MEMBER SCULLY: So, I think it's
15 wonderful that this is being emphasized. I would
16 say that there's probably still a lot of residual
17 skepticism on the part of the industry, as to
18 whether or not you can go to somebody within the
19 FDIC and complain about the FDIC. So, there's just
20 that natural skepticism that has to be overcome.

21 I think the best way to overcome it is
22 to just reiterate the message over and over again

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1 that this is taken very seriously. And with that
2 in mind, I'm not sure this is the vehicle to do it.
3 If I think about limited resources and limited
4 funds availability, that an annual report is going
5 to have that kind of iterative effect of really
6 making people less skeptical.

7 And I'd agree that some of the data
8 that's here, in isolation, just as data, is going
9 to raise a lot more questions than it's going to
10 answer. I mean, you know, we're all bankers, so
11 we look at these things -- you know, I look and see
12 that the public is the primary source of contact.
13 That really surprised me. And yet, the five topics
14 of interest, one of the greatest ones is
15 examination issues, which seems like a disconnect.
16 Is the public going to the ombudsman about
17 examination issues?

18 And, you know a total of 800 visits in
19 two years, given the number of institutions
20 insured, is that a message right now that we want
21 to send, or do we want to get that number up before
22 we advertise it.

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1 I mean, so, I'm just not sure this is
2 the vehicle. I think it's very important, but my
3 initial recommendation would be, I don't think this
4 is the vehicle to get that message across.

5 CHAIRMAN MCWILLIAMS: That's fair.
6 And this is one of the vehicles we want to use. And
7 to the extent that we use it, we want to make it
8 a viable vehicle. So, we're not just looking to
9 check the box. And you have my personal
10 commitment, I will highlight this in public
11 presentations, and encourage banks to use the
12 ombudsman process, and make sure people understand
13 it's truly independent from the rest of the FDIC,
14 and what people communicate to Anthony's office
15 does not get elsewhere, and we take those things
16 seriously.

17 So, I will personally take an
18 initiative, and you have my commitment that I will
19 go and advertise this as one of the main features
20 for banks to challenge, what they feel that hasn't
21 been done right, vis-a-vis our examinations, et
22 cetera.

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1 But if there are other ideas, I am very
2 much so open to it.

3 MEMBER EDWARDS: You know, I think this
4 is not easy, but I've been a banker for 25 years.
5 And other than working, when we were purchasing
6 assets of failed institutions, that's really the
7 only time I've worked with the ombudsman. And
8 about a year ago, Edie Fulcher in the Atlanta office
9 called me and said, hey, I'd like to come down and
10 see you. I just want you to know who I am, what
11 we do, what we can do for you, and, you know, make
12 sure you understand everything. And that was
13 really helpful.

14 She probably took an hour and a half.
15 We went through everything that the office does,
16 and what they can do, what they can't do. So, you
17 know, people deal with people. And so, I think
18 having that kind of one-on-one relationship now
19 would make me much more likely to reach out to her
20 when questions arise and things.

21 I know there are a lot of banks in the
22 country here, and that's an expensive way. But I

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1 think -- and I will say I know that the Office of
2 the Ombudsman really is at a number of banking
3 functions, through ABA, and ICBA, I'm sure, and
4 other functions. I appreciate that, and that's a
5 good way to meet folks, but that doesn't substitute
6 for being able to sit one-on-one across the desk
7 and have somebody in your shop do that. So, I know
8 that's probably expensive, but I think that's very
9 valuable time, and I appreciate the FDIC doing
10 that.

11 MR. LOWE: And I appreciate that
12 comment. And Mary, to your comment, you know, we
13 do realize, getting to 400, 500 banks on an annual
14 basis out of, you know, 3,600 or 4,000 that we
15 directly supervise, it's going to take us, you
16 know, six, seven, eight years before we get through
17 the entire cycle.

18 So, one of the items that we discussed
19 at our quarterly meetings and our annual meetings
20 is, how can we get the outreach and the numbers up?
21 Because I agree, the personal contacts are much
22 more important.

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1 One thing that I'm considering -- you
2 know, we do have some senior ombudsman specialists
3 that are here in Washington. I've been talking
4 with them. Some of them have not been out to visit
5 banks in several years, and they've indicated a
6 willingness to do that.

7 So, we are going to try to augment, you
8 know, the outreach, the actual outreach. Because
9 we do get much better, I think, information when
10 we do go on site and have those on-site visits.

11 One other note, you know, in regard to
12 those contacts that do come in from the public.
13 Some of those are -- they're categorized as from
14 the public, but they do come sometimes from
15 whistleblowers that actually work at banks and
16 maybe have an issue that has come up that they have
17 some concerns about, and they just want to report
18 it to us and say, hey, this may not be kosher, this
19 may not be legal, something.

20 You know, your folks may want to look
21 at during the course of the next examination. So,
22 a large number of those contacts that we get from

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1 the general public are those whistleblowers. And
2 they do of course want to -- it has to be a
3 confidential type of a contact.

4 MEMBER TOLOMER: I think I would echo
5 one thought, and that is, we've all probably worked
6 very hard with our local offices to have a strong
7 relationship, and we've been able to resolve
8 things. But in the off chance we're not able to
9 resolve things, I think it's comforting to know
10 there's another place to go to have a hearing,
11 beyond just butting heads.

12 Now, we haven't had any issues,
13 fortunately for us, in the 10-year existence. But
14 it's good to know that if there was an issue,
15 there's a place to go.

16 MEMBER HANRAHAN: So, Madam Chairman,
17 along the lines of what John just said, I think it's
18 a great idea to promote and educate on the
19 Ombudsman's Office. As you're promoting it, I
20 would respectfully suggest that the message be
21 delivered in a way that bankers don't think that
22 that should be their first recourse.

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1 Because whenever I've had to go to the
2 New York Region, R.D. Vogel and his team are great
3 at being responsive and accessible, and I've never
4 had to go to the Ombudsman's Office because we've
5 resolved things there.

6 So, I would hope that the message
7 couldn't be interpreted by bankers that that should
8 be their first place to go, because that would seem
9 to me to be a poor use of resources.

10 CHAIRMAN McWILLIAMS: Okay, I will
11 definitely -- and you'll see some stuff coming out
12 from the FDIC on the role of the ombudsman, and I
13 think you'll be pleased with an ability to provide
14 a comment letter perhaps.

15 MR. LOWE: David, you know, when our
16 regional folks go out, or when I go out and visit,
17 and if a banker does bring a matter forward, one
18 of the first questions I ask is, did you talk with
19 the EIC, with the local management, with the
20 regional folks? Because, I agree with you, that's
21 usually one of the best methods for getting
22 something resolved in a timely manner, so I always

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1 ask that question and my staff does too.

2 MEMBER HARTINGS: Anthony, just a
3 follow up on several of the comments that were made,
4 they were all great. I mean, I think the report
5 is good. I think you have to think about your
6 audience. I mean, I guess I think this report is
7 good if I'm your boss. It may not be quite as good
8 if I'm a community banker, because I want to know
9 the community bankers' aspects. So, I want to just
10 cut that out there.

11 And I've learned from regulators,
12 report it and then I can hold you accountable, so
13 I do appreciate you doing a report too, as far as
14 that goes.

15 MR. LOWE: Maybe I should rethink this.

16 (Laughter.)

17 CHAIRMAN McWILLIAMS: I'm getting all
18 kinds of ideas.

19 MEMBER HARTINGS: But I think you have
20 to start somewhere and then see where it grows.
21 Because if you want community bankers to be your
22 audience, it needs to be a different report.

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1 And again, because you're -- you've got
2 a lot of moving parts here. But again, I think
3 start it, do the best you can. It's accurate,
4 there's no doubt about it. But I want to know the
5 specifics. When you say examination issues, that
6 doesn't mean a lot to me because there's a wide --
7 and there's a lot of issues. But again, that's
8 because I'm reading it as a community banker, and
9 I really want those issues only brought up with
10 other bankers mostly, because it gets me an idea
11 -- you know, it just, and again, I may want the
12 public one as well, but again, that's slicing and
13 dicing it a little bit at that point.

14 MR. LOWE: Let me ask you, because one
15 thing, when I was talking to my staff earlier this
16 week, we werethinking about maybe building in some
17 information that would differentiate among the
18 asset size. You know, maybe up to 250, and maybe
19 having a couple of charts that show what issues came
20 up from different segments of asset sizes. Would
21 that help in that regard a little bit maybe?

22 MEMBER HARTINGS: I think that would be

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1 good. I'd go back to what I think Chris said. You
2 know, the problem is, it's not an objective view.
3 It's a very subjective view. It's the ones that
4 called you that you've viewed. Unless your
5 ombudsman is going to look at a wider number of
6 examinations, even those that, you know, again --
7 so, it's going to be limited value because, again,
8 it's just the ones that called you. And I
9 mentioned saying James Meyer in Columbus. He's
10 the one I call first. You know, so. I'm not sure.

11 Like I said, I think you have to just
12 do the report for a while and say where's the value?
13 I think you've got to watch your resources. Mary
14 Ann was exactly right. You've got to be careful
15 what you're trying to get out of this because,
16 number one, we want to make sure you're a line of
17 defense for bankers, that they know they can call
18 you without retribution, but don't call you first.
19 You know, all those kind of things is number one.

20 Reporting is important, but let's see
21 what we get out of the reporting. So, I mean, like
22 I said, once you start reporting, you have to kind

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1 of think of your audience and other things. That's
2 my only comment. I think all the other comments
3 have been great.

4 MEMBER EMMONS: And let me just put
5 another perspective on this. In addition to
6 knowing what it is and maybe going into more depth.
7 I think it would be very helpful for you to be able
8 to share in a very confidential way successful
9 outcomes. So, examples of conversations that have
10 taken place, where you have felt that you've
11 provided a valuable service to the organization,
12 and they would agree, that, you know, this was --
13 this process worked, it felt transparent, I feel
14 good about the outcome. Those kinds of things I
15 think would give us a better sense, not just what
16 the topic was, but how the office assisted the bank
17 in dealing with the issue.

18 MR. LOWE: Any other comments?

19 Well, we did have, hopefully at each of
20 your locations, contact information and my
21 personal business card. So, if you do have some
22 additional thoughts, email me, call me. I'll be

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1 here all day. Catch me at lunch or one of the
2 breaks. I definitely want to get some additional
3 input from you. So, thank y'all for your time.

4 CHAIRMAN McWILLIAMS: And thank you
5 all. This was a great discussion. I appreciate
6 it.

7 MR. DAVIS: And next up is lunch.
8 We'll be back here at 1:00.

9 (Whereupon, the above-entitled matter
10 went off the record at 12:00 p.m. and resumed at
11 1:04 p.m.)

12 MR. DAVIS: Okay, if we could please
13 have a seat, we will get started with the next
14 panel. Okay, welcome back, everyone. I would
15 start the afternoon portion of the meeting by
16 discussing industry collaboration issues. We
17 have Lisa Arquette from the Division of Risk
18 Management Supervision; Lisa is an Associate
19 Director who oversees our anti-money laundering
20 group. Betty Rudolph, the National Director for
21 Minority and Community Development Banking. And
22 Jim Watkins, Senior Deputy Director of Supervisory

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1 Examinations in the Division of Risk Management
2 Supervision.

3 Lisa is going to start by highlighting
4 the Shared Resource Statement regarding the Bank
5 Secrecy Act. Betty is going to discuss
6 collaboration with minority depository
7 institutions, and Jim is going to cover
8 collaboration with de novo institutions.

9 Thank you. Lisa?

10 MS. ARQUETTE: Thank you, Chad. And
11 good afternoon, everybody. It's a real pleasure
12 to be here. The slide deck that you have in your
13 materials is what I'm going to go over; it says
14 sharing resources to manage Bank Secrecy Act
15 obligations. And if you were following the press
16 releases on October 3rd we issued through a press
17 release some guidance, a statement for the industry
18 in considering initiatives to deal with efficiency
19 and effectiveness. The FDIC along with the other
20 federal banking agencies - the Board of Governors
21 of the Federal Reserve System, the Office of the
22 Comptroller of the Currency, the National Credit

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1 Union - and the Financial Crimes Enforcement
2 Network, FinCEN, we have issued a statement
3 regarding sharing of BSA resources. But before
4 that I would like to note just overall, there is
5 a bigger initiative underway, and that is to deal
6 with efficiency and effectiveness in the Bank
7 Secrecy Act anti-money laundering area; I'll refer
8 to it as BSA/AML regulations going forward. We're
9 also evaluating supervision in this space,
10 enforcement, and really is there anything that we
11 can do in terms of our examination process while
12 meeting the requirements of the statutes and
13 regulations, continuing to fully support law
14 enforcement, recognizing innovation in AML
15 techniques and reducing the burden of BSA/AML
16 compliance. Again, our partners are the other
17 banking agencies as well as FinCEN.

18 Moving along to Slide 2, on October 3rd
19 we issued our press release and it deals with the
20 burden of BSA/AML obligations that have been raised
21 many times by the industry as well as other parties.
22 The cost of meeting BSA requirements and

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1 effectively managing the risk that illicit finance
2 poses to the broader U.S. financial system may be
3 reduced through sharing employees or other
4 resources and collaborative arrangements with one
5 or more financial institutions. Collaborative
6 arrangements involve two or more banks with the
7 objective of participating in a common activity or
8 pooling resources to achieve a common goal. The
9 statement describes how collaborative
10 arrangements can be used to pool human,
11 technological and other resources to reduce costs,
12 increase operational efficiency, and leverage
13 specialized expertise.

14
15 Moving onto Slide 3; the collaborative
16 arrangements described in this interagency
17 statement are most suitable for banks with a
18 community focus, less complex operations and lower
19 risk profiles for money laundering and terrorist
20 financing. I should also point out, although it
21 may not pertain to anybody here, that this
22 statement does not apply to collaborative

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1 arrangements or consortia that are formed for the
2 purpose of sharing information under Section
3 314(a) of the USA PATRIOT Act which is known as the
4 voluntary information sharing, Section B, it's
5 between banks. So there are many banks that have
6 voluntary consortia to share information. It's a
7 little more simple than that; as a reminder, banks
8 are required to establish and maintain procedures
9 reasonably designed to ensure compliance with the
10 Bank Secrecy Act and to develop and implement
11 BSA/AML compliance programs; those programs should
12 be commensurate with the bank's specific risk
13 profile. The risk profile of a bank should be
14 based on the institution's risk assessment that
15 properly considers all risk areas such as products,
16 services, customers, entities, transactions and
17 geographic locations in which the bank operates and
18 provides services. The BSA compliance program is
19 illustrated on Slide 4 and includes a system of
20 internal controls to ensure ongoing compliance
21 with the Bank Secrecy Act, independent testing of
22 the BSA/AML compliance program, a designated

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1 individual or individuals responsible for managing
2 BSA compliance, training for appropriate
3 personnel, board members all the way down to
4 staff-level personnel, an established customer
5 identification program, procedures for customer
6 due diligence, which became effective in May of
7 this year. Collaborative arrangements may
8 provide access to specialized expertise to assist
9 banks in meeting the BSA/AML compliance program
10 requirements that may otherwise be challenging to
11 accomplish without such collaboration.

12 Slide 5. I would like to provide a
13 couple of examples to describe situations in which
14 collaborative arrangements may be beneficial for
15 banks. In terms of internal controls, the
16 internal control requirement, a collaborative
17 arrangement might be entered into by two or more
18 banks to share resources between the respective
19 institutions to conduct certain internal control
20 functions such as reviewing, updating and drafting
21 BSA/AML policies and procedures, reviewing and
22 developing risk-based customer identification and

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1 account monitoring processes, tailoring and
2 monitoring systems and reports for the risks posed
3 by each institution. In terms of the independent
4 testing requirement, banks are also required to
5 provide for independent testing to determine that
6 the bank is in compliance with the Bank Secrecy Act;
7 that can done either internally or it can be done
8 with an outside party. Such testing should
9 provide an evaluation of the adequacy and the
10 effectiveness of the bank's BSA/AML compliance
11 program. Some banks may have personnel that
12 perform multiple job functions making it difficult
13 to identify an employee within the bank to conduct
14 an independent test of the Bank Secrecy Act/AML
15 compliance program. Personnel at one bank might
16 conduct the BSA/AML independent test at another
17 bank with a collaborative arrangement between the
18 two; the shared resource may, for example, be
19 utilized in scoping, planning, and the performance
20 of BSA/AML independent testing. With that said,
21 appropriate safeguards should be in place to ensure
22 confidentiality of sensitive business

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1 information. The banks should be involved in the
2 collaborative arrangement, the banks that are
3 involved in the collaborative arrangement also
4 need to ensure that the shared resource conducting
5 the BSA/AML independent testing is qualified and
6 not only with the BSA/AML functions, but in the
7 materials that are being reviewed, such as training
8 and developing policies and procedures. We want
9 to ensure that this does not present a conflict,
10 so the employees should be trained and should be
11 independent. In terms of the training
12 requirement, banks are required to ensure that the
13 appropriate personnel are trained in BSA
14 regulatory requirements and in internal BSA/AML
15 policies, procedures and processes. It may be
16 challenging to acquire personnel with BSA/AML
17 expertise in some communities; it may also be cost
18 prohibitive to attract a qualified, off-site
19 BSA/AML trainer; however, in a collaborative
20 arrangement between two or more banks, there is
21 latitude in hiring a qualified instructor to
22 conduct the BSA/AML training, allowing the banks

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1 to share the costs. Examples of basic BSA/AML
2 training topics may include alerting - the alert
3 analysis in investigative techniques, alert trends
4 in money laundering methods, as well as regulatory
5 updates.

6 Other considerations; when considering
7 a collaborative arrangement for a BSA officer, we
8 think that there might be many challenges that
9 community banks might face. The sharing of a BSA
10 officer among banks could be challenging due to the
11 confidential nature of suspicious activity reports
12 filed and the ability of the BSA officer to
13 effectively coordinate and monitor each bank's
14 day-to-day BSA/AML compliance. In addition, the
15 sharing of a BSA officer may create challenges with
16 effective communication between the BSA officer
17 and each bank's Board of Directors and senior
18 management. Accordingly, it may not be
19 appropriate for banks to enter into collaborative
20 arrangements to share a BSA officer; in certain
21 circumstances it may be appropriate to share an
22 officer but we do think that you should raise the

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1 issue with your regulator, the FDIC, before doing
2 that.

3 I would like to move onto Slide 9, Risk
4 Considerations and Mitigation; the use of
5 collaborative arrangements to manage BSA/AML
6 obligations requires careful consideration,
7 collaborative arrangements should be consistent
8 with sound principles of corporate governance. A
9 bank's Board of Directors should provide for
10 appropriate oversight of BSA/AML collaborative
11 arrangements in advance of entering into these
12 arrangements. Reasonable systems should be
13 established to ensure that bank management
14 adequately oversees the activities of the shared
15 resources, banks should devote sufficient
16 resources for monitoring the services performed
17 under the collaborative arrangement. Another
18 standard practice is to support the collaborative
19 arrangement with the contractual agreement between
20 the parties. A collaborative arrangement for
21 sharing employees or other resources to manage
22 BSA/AML obligation is similar to using dual

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1 employees. Periodic reports related to BSA/AML
2 collaborative arrangements should be provided to
3 senior management and reported to the Board of
4 Directors as appropriate in conjunction with
5 regular oversight of bank activities. Banks must
6 also comply with all applicable legal
7 restrictions, including limitations on the
8 disclosure of confidential supervisory
9 information, confidential and business
10 information, individual customer data, and trade
11 secrets, as well as restrictions governing
12 collaborative arrangements among competitors. A
13 collaborative arrangement should be appropriately
14 documented to define the nature and type of
15 resources to be shared, define each institution's
16 rights and responsibilities, establish procedures
17 for protecting customer data and confidential
18 information, and develop a framework to manage
19 risks associated with sharing resources.

20 That concludes my comments. I'd be
21 happy to either take questions now or at the end
22 of the presentation.

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1 MEMBER K. KELLY: Lisa, is there data
2 that suggests a range of anticipated savings for
3 looking at this level of collaboration? I think
4 many of us probably have an idea of what it costs
5 us, but is there any research on that?

6 MS. ARQUETTE: We don't currently have
7 research. I mean, we know that some banks are
8 already engaging in collaborative arrangements
9 whether by contract or otherwise. We know that
10 banks share resources for training purposes,
11 independent testing - it's similar to a third
12 party, commitment with an outside party, but we do
13 not have the data right now on what the cost savings
14 would be.

15 MEMBER K. KELLY: I understand.

16 MS. ARQUETTE: Thank you.

17 MEMBER K. KELLY: Thanks, Lisa.

18 MEMBER PAINE: We actually have been
19 doing this for over six years, and it's not just
20 BSA; we have some banks that are \$25 million and
21 they just don't have the expertise in-house, or the
22 ability to have independent testing of much. So

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1 we actually have been helping them with internal
2 audits, like I said, for over six years, and
3 ultimately we put together an engagement letter and
4 we do it at a discounted rate basically to cover
5 the training of our employees and allow for
6 redundancy on our end. It's worked out well; it's
7 been a good benefit for both.

8 MS. ARQUETTE: Yes, we think that it's
9 a good practice and we wanted to really highlight
10 the benefits of doing that.

11 MEMBER PAINE: We work with six other
12 banks -- seven other banks, I'm sorry.

13 MS. ARQUETTE: That's good to know.

14 MEMBER DONNELLY: Just a question for
15 -- how do you see bank or state bank associations
16 being involved? We use a state bank association
17 to do some audits and some back testing, but this
18 is more forward-looking than looking from your rear
19 view mirror. So have you thought how that would
20 come into play as to contractually for the front
21 end or -- I hope I'm making sense, because when I
22 read this I was intrigued by it when it came out

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1 because it is a large cost for us.

2 MS. ARQUETTE: Absolutely. Well, I
3 guess it would be like any third party, right;
4 somebody not in the bank conducting different types
5 of BSA compliance obligations, regardless of the
6 third party, just knowing what the
7 responsibilities are of each party, monitoring to
8 make sure that what you've contracted for, what
9 you're paying for is what you're getting. So I
10 would view that as any third-party relationship,
11 if that makes sense.

12 MEMBER DONNELLY: Mm-hmm.

13 MEMBER SHETTLESWORTH: This seems like
14 a proactive solution that I'd not been aware of and
15 not even thought about, and I can assure you we'll
16 bring it up at our state association meetings in
17 the following years. So this is fascinating to me,
18 but I hope it doesn't just necessarily stop here
19 from the FDIC's standpoint because over the number
20 of years, over the last three to four years this
21 concept has been brought about concerning
22 mortgages, residential mortgage loans having some

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1 type of shared originator and compliance function
2 within the state that state member banks can
3 participate in. And so, this is proactive, I'm
4 very curious about it, but hopefully this kind of
5 proactive thinking continues because this is
6 fascinating.

7 MS. ARQUETTE: Well, you'll see more in
8 the BSA/AML space, but I can't speak to anything
9 beyond that.

10 MEMBER SHETTLESWORTH: Okay.

11 MR. WATKINS: I do think it's probably
12 fair to suggest, though, it could have implications
13 more broadly for other operations of the bank and
14 we would encourage that as well.

15 MS. RUDOLPH: Excuse me. Okay, good.
16 So as Chad mentioned, my name is Betty Rudolph and
17 I am responsible for mission-oriented banks,
18 minority banks and community development banks.
19 And that's a portfolio of approximately 155 banks
20 across the country; half of them serve Asian
21 communities, about 25 percent Hispanic, about 15
22 percent African American, and 12 percent Native

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1 American banks. And this program is supporting
2 five statutory goals that we have to preserve and
3 promote minority institutions and an FDIC policy
4 statement in that regard as well. And so the
5 initiative I'm going to talk about today is a
6 collaborative initiative similar to what Lisa
7 talked about for minority banks to collaborate
8 either with other minority banks or with
9 non-minority banks in a variety of areas. And to
10 support this initiative we published a resource
11 guide late last December and we've been sort of
12 promoting that this year, and so I'm going to go
13 through that, and it's also in your packet called
14 Resource Guide for Collaboration with Minority
15 Depository Institutions.

16 So one of the impetuses behind it is
17 that both MDI, minority depository institutions,
18 and non-minority banks can receive regulatory and
19 business benefits from collaboration and
20 partnering, and that MDIs are often more familiar
21 with the economic development needs in their
22 communities, and non-MDIs can benefit from sound

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1 and profitable lending and other relationships,
2 and investments in under-served communities. And
3 so the remaining slides I'm going to go through what
4 some of those collaborative opportunities might
5 look like. So on Page 3 just the four
6 collaborative arrangements could include direct
7 investment in an MDI, loan participations or other
8 lending arrangements, sharing of bank staff and
9 other resources similar to what Lisa talked about,
10 and information networking. So I'll describe each
11 of those a little bit more in detail. So direct
12 investments would include placing deposits in an
13 MDI, making a direct capital investment or
14 participating in a fund that makes direct
15 investments in an MDI.

16 On Page 5 with respect to loan
17 participations; some of the benefits of that are
18 expanding MDI capacity so they are able to engage
19 in larger loan transactions. So we have examples
20 of a very large bank in Texas, a \$25 billion bank
21 that's doing loan participations with an MDI sort
22 of at a \$2 million, \$1 million level rather than

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1 the \$10 to \$15 million level which that bank
2 normally engages in. The collaboration through
3 loan participations also provide access to special
4 resources or unique skill sets that the
5 collaborating institution may have that the MDI may
6 not have. And they create opportunities on both
7 sides of the partnership to diversify loan
8 portfolios, enhance liquidity and interest rate
9 risk management and serve the credit needs of a
10 wider range of customers.

11 So in terms of the loan participations,
12 partnerships could take the form of lending
13 consortia, community development financial
14 institution, CDFI, community development
15 entities, loan funds or special purpose entities
16 that might be created, limited liability
17 corporations to manage troubled loans or other real
18 estate owned. And we have some examples of where
19 MDIs have collaborated in this space as well, some
20 of them using new markets, tax credits to engage
21 in much larger projects that the MDI might not have
22 been able to engage in on their own.

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1 Turning to sharing bank staff or other
2 resources; examples include providing access to
3 specialized skill sets through bank staff or
4 consultants; these could include human resources.
5 We have a number of institutions that have lent
6 talent management services to MDIs, internal
7 audit, asset valuation, or managing problem
8 assets, expertise in niche lending - for example
9 SBA lending, as well as waiving ATM fees for MDI
10 customers. Citibank has made available their
11 ATMs, about 2,400 nationwide for a group of about
12 27 minority banks and low income credit unions to
13 use without out-of-area fees.

14 In terms of information networking,
15 trade organizations that focus on underbanked or
16 unbanked consumers provide training information on
17 the availability of MDI investment opportunities.
18 And the FDIC also provides a number of networking
19 opportunities, including regional roundtables for
20 MDIs once a year and an interagency conference
21 every couple of years for opportunities to network.

22 MEMBER TURNER: Is that opportunity

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1 for them to network among themselves or with
2 potential people to partner with as well?

3 MS. RUDOLPH: Yes, we have had
4 instances where we've brought together MDI trade
5 groups with CEOs of non-MDI institutions to explore
6 those opportunities. The last one we did was in
7 Salt Lake City with a number of the ILCs and they
8 kind of made their pitch for the ILCs for what their
9 needs might be in that case; they were looking for
10 Community Reinvestment Act consideration. There
11 weren't as many opportunities in Salt Lake and so
12 we brought MDI trade groups to share what they were
13 looking for as well.

14 MEMBER TURNER: I think those will be
15 helpful to involve a broader audience, so maybe
16 some networking could be done and relationships
17 established.

18 MS. RUDOLPH: That's a great idea, yes.
19 The other -- and I was going to get to this at the
20 end but we can talk about it now -- a number of state
21 associations as well, MDIs have brought forward
22 this actual resource guide as we've been promoting

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1 it to other state associations and looking for
2 potential partners and had some receptivity to that
3 as well. So there are a number of different
4 channels for doing that.

5 So turning to Slide 9 on community bank
6 benefits; enables partners to serve bank customers
7 that neither institution could serve alone, has the
8 potential to reduce operating and compliance costs
9 by sharing back office operations and specialized
10 expertise, and jointly developing products and
11 services at reduced costs.

12 So turning now to Slide 10 which is
13 opportunities for CRA consideration. So all
14 banks, including everyone sitting at this table,
15 receive consideration under the CRA for activities
16 in their assessment areas and the broader
17 state-wide or regional area if it's responsive to
18 the community development needs in their
19 assessment area. And non-MDIs can also receive
20 consideration if they partner with a minority
21 institution outside of their geographic area. So
22 when we had that roundtable in Salt Lake City, for

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1 example, those institutions were looking with
2 partnering with MDIs across the country and had the
3 potential to earn CRA consideration for those
4 partnerships.

5 MEMBER TURNER: So the CRA credit you
6 earn, you don't have to partner with a MDI located
7 in one of your --

8 MS. RUDOLPH: Assessment areas, that's
9 correct.

10 MEMBER TURNER: Assessment areas.

11 MS. RUDOLPH: And the consideration is
12 that it benefits that MDI in a location where
13 they're chartered. So some examples of that
14 making a deposit or capital investment like we
15 talked about, purchasing or selling a
16 participation in an MDI's market areas, so, Joe,
17 some of those examples included MDIs looking for
18 earning assets from a bank outside of its local
19 area. So those would qualify as well. Loaning an
20 officer or providing other technical expertise,
21 providing free or discounted data processing
22 systems, and contributing -- the value of the

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1 contribution or the loss incurred by donating,
2 selling below market rate or renting for free a
3 branch that's located in a minority neighborhood.
4 And that has occurred as well.

5 So just turning to the last slide, Slide
6 12, just some points on finding MDI partners; FDIC
7 has regional MDI coordinators in each of our six
8 regional offices. We also have community affairs
9 regional managers that are familiar with their
10 area, state or regional trade associations,
11 community development or CRA associations in the
12 states are a good place also to look for
13 collaborative opportunities, and then MDI trade
14 associations.

15 MR. WATKINS: I'd like to also just
16 follow up a little bit; this suggests that each of
17 our regions has CRA specialists and they would be
18 available too to help ensure that you're getting
19 attention or the investment interests that you
20 would want in such an investment. So reach out to
21 them as well.

22 MEMBER TURNER: So if we're interested

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1 in some of these opportunities or at least finding
2 out about them, that's who you would suggest we call
3 first?

4 MR. WATKINS: I think you have two
5 choices; you can work through our MDI coordinators
6 in concert with a CRA specialist who really are the
7 experts in CRA matters.

8 MS. RUDOLPH: And we maintain a list of
9 these minority banks on our website, so it's
10 fdic.gov/mdi and there's a whole website there.
11 And I'm also available here in Washington if you
12 have some questions about that as well.

13 MEMBER K. KELLY: I'd also like to
14 offer, I'm serving as a new chairman of the Minority
15 Banking Association and would be happy to speak
16 with any of my colleagues here in looking at
17 potential loan participations, et cetera that
18 could help strengthen those institutions while
19 you're also getting CRA credit. We'd love to make
20 ourselves available for that.

21 MS. RUDOLPH: Thanks, Ken.

22 CHAIRMAN McWILLIAMS: And we're also

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1 looking to increase the participation of MDI
2 members on this committee as well, so you'll have
3 a broader audience for the engagement and pursue
4 some of these ideas as well.

5 MR. WATKINS: So next I'd like to
6 discuss a little bit on the efforts the FDIC is
7 taking for de novo bank formation; so that's new
8 banks, if you will; we call them de novo
9 institutions. And to promote and encourage the
10 formation of de novo banks; in 2016 and in 2017 FDIC
11 staff participated in day-long sessions at each of
12 our regional offices, meeting with potential new
13 organizers for de novo institutions and other
14 parties that have interests in forming de novo
15 institutions. And so we had our day-long agenda
16 where the regulators, we had both state regulators,
17 the Office of the Comptroller of the Currency for
18 national banks, the Federal Reserve was there, of
19 course FDIC officials were there. We walked
20 through the application process, we talked about
21 the statutory factors, we described business plans
22 and how to develop business plans and what's

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1 expected there. And there was another session on
2 Community Reinvestment Act and how to complete that
3 part of the application, if you will. But without
4 a doubt, the highlight of the day, and we get this
5 from the feedback after the session, was a session
6 that bankers participated in, so there was a panel.
7 So this wasn't the regulators; this was a panel of
8 bankers that described their experiences and kind
9 of lessons learned in forming de novo banks, and
10 some of the lessons that came out of that was the
11 level of cooperation and collaboration that
12 bankers achieved. And in fact, some members here
13 I know today participated on those panels, and I
14 hope you speak up. For example, every bank will
15 need a loan policy, right? So every bank will need
16 a loan policy and organizers found a lot of success
17 in just reaching out to other bankers, existing
18 banks, that provided them copies or drafts of loan
19 policies. And they can use it as kind of an
20 outline, at least, in developing their own
21 policies. And there was a lot of policies that
22 bank regulators happened to like; loan policies

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1 would be one; there's also an interest rate risk
2 policy, funds management policy, and CRA policy.
3 So this level of interest in collaboration, I
4 think, was informative to those interested in
5 organizing a bank that they could actually reach
6 out to other existing bankers, and they were very
7 helpful in providing suggestions and useful tools
8 in consideration of formation of a business plan,
9 for example.

10 Another issue that any time you form a
11 new business, it's a very difficult, delicate
12 period and it takes a while to achieve
13 profitability. And so there was some success
14 achieved through loan participation. So this is
15 where one bank will help provide initial credit,
16 if you will; you can buy a loan participation, so
17 you're building up a relationship, and also
18 existing banks will readily provide, in many cases,
19 correspondent banking relationships. So if you
20 can't serve all of a particular customer's needs,
21 maybe through the relationship you can establish
22 from a correspondent bank, it can provide those

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1 services until this new bank is able to build up
2 its staff and expertise and systems in place.

3 Another lesson I think that came out of
4 this quite strongly was information technology, so
5 that's a huge challenge for all of us, and is
6 particularly a challenge when you're forming a new
7 company or a new bank in particular. And some of
8 the lessons that came out of this kind of around
9 this collaboration and cooperation was the fact
10 that you can share experiences in developing your
11 contracts, and probably the best time to negotiate
12 the things you want in that contract is when you
13 first sign an original, initial contract for
14 services. So it was a remarkable amount -- in my
15 sense anyway -- there was a remarkable amount of
16 interest by other banks, existing banks in
17 supporting the formation of new banks, and it's an
18 extraordinary resource that can be made available
19 for de novo institutions. So that was a big lesson
20 that came out from our day-long sessions around the
21 country; clearly the feedback forums was much
22 better than what the regulators provided, if you

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1 can believe that. And I think the organizers that
2 were considering forming new institutions really
3 gained a lot of insight from that, and we are
4 starting to see revised interest in forming new
5 banks, and so we're very much encouraging that.
6 And anything you could do to help support that we
7 would appreciate. So I'm hoping, John, maybe you
8 can add to that if you had any other comments in
9 regards to your sessions and the collaboration that
10 you thought might be useful, for example.

11 MEMBER HANRAHAN: You summarized it
12 very well, Jim. I think one of the biggest
13 takeaways for me from that outreach effort was
14 there had been, and to some degree still exists a
15 perception that the regulators have constantly
16 ratcheted up the capital levels required for a new
17 bank, and not only ratcheted them up but made a
18 mysterious black box that organizers just weren't
19 told how much capital had to be raised. And if I
20 recall correctly, it was Doreen who explained at
21 the New York meeting that I attended is that,
22 look, we don't have a minimum capital level, other

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1 than you've got to maintain a 8 percent leverage
2 ratio for your first three years, on your first
3 capital raise, and show you can turn a profit inside
4 those three years. You tell us how much capital
5 you need to fulfill that business plan. I thought
6 it was logical and elegant the way it was stated,
7 and from the de novo approvals that I've seen so
8 far, I've seen a varied range of capital levels
9 approved depending upon what that business plan
10 was. And I commend the FDIC for taking that
11 approach too.

12 MR. WATKINS: That's the first time
13 I've ever heard eloquent in relation to capital.

14 (Laughter.)

15 CHAIRMAN McWILLIAMS: No, they told us
16 to describe somebody else.

17 (Laughter.)

18 MR. WATKINS: Fair enough.

19 MEMBER TOLOMER: I think, Jim, just to
20 get to your point and I think David's, we were in
21 the New York session together, and I think one of
22 the things we were able to do is to try to explain

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1 to potential board members, to potential CEOs what
2 some of the challenges are to actually starting;
3 it's great to build a business plan, it's great to
4 say that you're going to have 8 percent capital in
5 the next three years and be profitable, but how do
6 you get to it, and how do you utilize, we talked
7 a lot about technology and utilizing technology to
8 reduce the number of people, but be able to increase
9 the size of your business and customer base. So
10 I think there was a good exchange for people to
11 understand -- and David is right; they were very
12 anxious, they wanted to put up as little capital
13 as possible, but the reality is it's all about the
14 business plan and trying to understand what is it
15 you're trying to do with this bank that you're
16 starting, what is your niche, who's your customer
17 and how do you go about being successful. So I
18 think we were trying to help focus where they were
19 going to go with their business and with their bank
20 and recognizing it's all well and good to have
21 capital but can you turn a profit. And if so, how
22 do you continue to build. So I think the feedback

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1 I received in the two sessions I went to was that
2 they found it very helpful to hear someone whose
3 gone through the process and lived with it, and the
4 other thing I think we made pretty clear was that
5 we didn't view the regulators as the enemy; we
6 viewed the regulators as partners, and we viewed
7 the fact that being able to tell the regulators what
8 we were doing as we were doing it I think was very
9 beneficial certainly for our bank when we did it,
10 and I think although what we started in 2008 and
11 the first time I called to have a joint meeting,
12 a lot of people showed up thinking that we were
13 throwing keys back in 2009.

14 But the reality was I think that started
15 a strong relationship in working and encouraging
16 new banks to be able to -- they have nothing to hide,
17 be open and honest and forthright, and in the end
18 that would help them. So that was kind of the
19 message that I think we were bringing forward. And
20 the feedback that I got from the potential
21 investors was very positive.

22 MEMBER HANRAHAN: Related to our

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1 ombudsman conversation earlier, one of the
2 comments I made on that panel was the importance
3 of maintaining open face-to-face communication
4 with your original office, and it's funny you're
5 making this presentation because the anecdote that
6 I gave was, oh, yeah. I'm telling it.

7 (Laughter.)

8 MR. WATKINS: So we can move on, Chad,
9 at any time.

10 MEMBER HANRAHAN: Early on in our
11 history I inadvertently violated our business plan
12 that had been approved. And so I decided not to
13 try and resolve it over the phone or via letters,
14 but I went hat in hand to the regional director of
15 the New York office who at the time was Jim Watkins
16 and sat with him and his staff and we worked it out.
17 And I didn't get everything I wanted, he probably
18 didn't get everything he wanted, but we reached a
19 middle ground that worked for us and got it through
20 an issue related to brokered deposits.

21 CHAIRMAN McWILLIAMS: But David, was
22 he eloquent?

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1 (Laughter.)

2 MR. WATKINS: We don't have to worry
3 about that.

4 MEMBER DONNELLY: Well, this is
5 important to me and I appreciate the comments --
6 it's good stuff -- the devil's always in the detail.
7 So as you start to work through that, where do you
8 find that detail? There's a lot of little pieces
9 that need to be input. And is there a place -- so
10 it's not continually back and come back and come
11 back and come back with more and more information
12 that -- what would your recommendation be?

13 MR. WATKINS: So we very much encourage
14 banks to work with other banks. In the formation
15 of a de novo institution, really the business plan
16 is extraordinarily important, and the concept of
17 the business plan. Where banks have run afoul, if
18 you will, is when they deviated sharply from the
19 original business plan. Usually the business plan
20 is a pretty good road map of a path to successful
21 operations for a financial institution. And you
22 can have deviations from the business plan as long

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1 as they're well-informed and thought through, and
2 structured in such a way that it will lead to
3 sustained profitability. So if an institution
4 needs to change its business plan or add new
5 products or something of that nature, it's good to
6 get that discussed early on -- not after the fact
7 -- early on with your friendly regulator to ensure
8 that everyone's on the same page and the
9 expectations are pretty clear. So I think that's
10 an important environment. And frankly where we've
11 seen banks run into trouble is when they
12 substantially deviate and they grow rapidly, far
13 more rapidly than they had originally anticipated.
14 And without the control systems in place early on,
15 it can end up leading to kind of excess risk and
16 that sort of thing. So I think that is an important
17 initiative and I think when banks enter into
18 relationships with other parties, the third-party
19 guidance is valuable and should be considered as
20 you're forming those relationships, and consider
21 all of those factors.

22 MEMBER MENON: So when we were a de novo

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1 back in '08 any variations we were looking for from
2 the plan had to be approved by Washington. Is that
3 still the case or has that been delegated back to
4 the regional offices?

5 MR. WATKINS: So almost all deviations
6 from a plan, first of all, it has to be substantial
7 like 25 percent or something of that nature, a
8 substantial deviation from a plan, before it would
9 require regulatory prior approval, and I believe
10 the regions can pretty much do that on their own
11 now at this point.

12 MR. DAVIS: Any other additional
13 questions? I see our next presenters are here, so
14 we're a little ahead of schedule, but we'll move
15 to the next panel.

16 Thank you very much to this panel.

17 CHAIRMAN McWILLIAMS: This may be the
18 only thing ahead of schedule in D.C., so enjoy.

19 (Laughter.)

20 MR. DAVIS: Our next session is
21 something that came up at our July meeting and we
22 committed to provide a briefing on assessment

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1 pricing for small institutions. From the FDIC's
2 Division of Insurance and Research we have Diane
3 Ellis, the Director and Patrick Mitchell, Deputy
4 Director of Risk Analysis and Pricing.

5 MS. ELLIS: Okay, thanks. Happy to be
6 here to talk about deposit insurance pricing. Pat
7 will -- we've got a few slides in your folder, not
8 many -- and Pat will walk through those which is
9 designed to give you some context for overall
10 assessment rates, overall assessment burden and so
11 forth, and then also some of the particulars of the
12 small bank deposit insurance pricing system, which
13 just by way of background, has been in place for
14 a couple years now, and it replaced a system that
15 looked and felt sort of like the current system.
16 But the underlying methodology was different, the
17 underlying methodology of the old system was put
18 in place in early 2000's and was essentially a
19 CAMELS downgrade, a prediction of a CAMELS
20 downgrade. And that's what drove the factors that
21 were chosen and the weight given. With 500 plus
22 failures of the most recent banking crisis it

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1 presented sort of an opportunity to see if we
2 couldn't do a better job of having a better model
3 to better differentiate risk. So the underlying
4 model that drives the small bank pricing system now
5 is a failure prediction model and it uses data going
6 all the way back to the mid-1980's, so it's a very
7 long period of time, many, many failures, and
8 that's essentially what drives the ratios that are
9 chosen and the weights placed on those different
10 ratios.

11 So with that as background, now I'll let
12 Pat walk you through some of these slides. And
13 there should be plenty of time for questions
14 afterwards. Please don't hesitate to stop us
15 along the way if you'd like.

16 MR. MITCHELL: Thanks, Diane. So
17 sure, any time questions along the way, happy to
18 answer them; if you want to stop me along the way,
19 feel free. I know you typically do.

20 So I'm going to walk through the slides
21 and I'll start with the average assessment rate
22 over time. And so this slide starts in second

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1 quarter of 2011, and the reason why it started there
2 was that was when the assessment base was changed,
3 and so the rates wouldn't have been comparable if
4 we would have gone further back. So this shows the
5 average assessment rate over time has declined from
6 11.8 basis points -- this is in basis points -- down
7 to the current 3.7 basis points. So that's been
8 a combination of a couple things; one is obviously,
9 it's been a significant improvement in the
10 financial performance across the industry, but
11 also you can see here one contributing factor was
12 almost a two basis points decline across the
13 industry when the rate schedule changed when we hit
14 1.15, so that was when the rate schedule changed
15 from 5 to 35 basis points to 3 to 30 basis points.

16 So this is really, I mean, quite a
17 remarkable story and quite a strong story to show
18 the decline over time. So now --

19 MEMBER TURNER: And that's against
20 insured deposits is that right? Or assets?

21 MR. MITCHELL: So this is actual the
22 assessment rate that gets applied against your

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1 assessment base, which is effectively your
2 liabilities.

3 MEMBER TURNER: Okay.

4 MR. MITCHELL: So the next one I'm
5 going to put it in context of income, which I think
6 is probably the most relevant. The next slide
7 shows the -- it's the same, similar slide; it shows
8 the effective assessments on bank income, and this
9 is again, using that same time frame, and this
10 shows, again, the burden if you will has gone from
11 7-1/2 percent down to 2.1 percent of pre-tax income
12 that we actually add back assessments because
13 otherwise it gets a little odd, but I think the key
14 point here is that this is, again, a multi-factor
15 process; one is incomes, income has increased
16 across the industry, so that's actually
17 contributed to this. But also, of course, on the
18 preceding slide you saw the lower assessment rates
19 overall. So again, a strong story and with a
20 significant decline here from 2016 -- this is 2017
21 -- I would anticipate this to really flatten; as
22 you saw the 3.7 basis points on average, it appears

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1 to be it's still declining a little bit, but we
2 expect it to flatten more as opposed to continuous
3 declining, absent of course, increased income
4 growth on this page.

5 So on the next page we put assessments,
6 and this shows the percentage of small bank
7 assessments as a percentage of total assessments,
8 and so what this is really intending to show are
9 a few inflection points here; in particular the
10 change in the assessment base that I mentioned, so
11 that was a result of Dodd-Frank, and so Dodd-Frank
12 required us to effectively go to total liabilities.
13 It's total assets minus tangible equity, but in
14 short term we'll call that liabilities. And the
15 intention of that was really to have assessments
16 be closer related to the overall assets -- I mean,
17 that was the intention of the Congress, and so you
18 can see that change from 30 percent of assessments
19 in small banks down to 20 percent, which was roughly
20 in line with the amount of assets in the industry.
21 So that was a big shift from small banks to large
22 banks in terms of the overall assessment burden.

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1 You can see it really kind of, I'll call
2 it treaded water along the 20 percent over time
3 until the decline in the rate schedule, and this
4 declined down from 20 percent to approximately
5 we'll call it 11-12 percent, and now down to 10
6 percent was a result -- that's including the large
7 bank surcharge that's been placed on them to grow
8 the fund from 1.15 percent to 1.35 percent. So
9 there's a surcharge on the large banks of 4-1/2
10 basis points and that reflects that. Now, what we
11 expect when we hit 1.35 which we expect to hit later
12 this year, we possibly could have already hit it
13 today, we just don't know it -- we need to see the
14 reported amount of insured deposits and so on and
15 so forth -- so we'll report those with the quarterly
16 banking profile. But we expect that 10 percent to
17 increase back up and around the 20 percent level
18 again.

19 MEMBER K. KELLY: Can you explain that,
20 why is that again?

21 MR. MITCHELL: So right now there's
22 large bank surcharges that are in place to grow the

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1 fund from 1.15 to 1.35 percent, so that was again
2 part of the required by Dodd-Frank with the
3 increase for our minimum reserve ratio from 1.15
4 to 1.35. Once we hit 1.35 the surcharges will
5 terminate. And so now you won't pay any -- the
6 small banks won't be paying any larger, but as a
7 percentage that will be gone and so now it will be
8 closer to the assessment base. Does that make
9 sense?

10 MEMBER K. KELLY: It does.

11 MR. MITCHELL: Okay. The next page
12 shows the distribution of assessment rates, and
13 this is for all small banks, for those \$10 billion
14 or less. And so the rate schedule is currently 3
15 to 30 basis points, so that's the minimum assessment
16 rate without what we call the below the line
17 deductions, so if you issue unsecured debt you can
18 go below 3 basis points. But what you can see here
19 is over 60 percent of small banks pay 3 basis points
20 or lower, so over a majority pay 3 basis points or
21 lower and then the distribution is spread out as you
22 can see.

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1 I don't know where each of you all fit
2 in this but you might find yourself here.

3 The next page goes into the factors used
4 in small bank pricing, so they're actually pretty
5 straightforward; you have CAMELS ratings and I'm
6 not showing the weightings here because they're
7 really not super intuitive. I'm going to talk on
8 the next page about what the largest drivers are in
9 the pricing, but if you just look at the weightings
10 per se, it's a coefficient; they're not really
11 intuitive; but weighted-average CAMELS, leverage
12 ratios, capital measure, the net income before
13 taxes, again an income measure, non-performing
14 loans and other real estate owned, those are both
15 asset quality measures. The brokered deposit
16 ratio, again, that's only for brokered that are
17 greater than 10 percent, and again reciprocals are
18 currently excluded for being well-rated -
19 well-rated and well-capitalized institutions.
20 And then the Loan Mix Index and the one-year asset
21 growth; I think the point of this, these are all
22 statistically derived, and so they are all used, as

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1 Diane had mentioned, as a predictor using the
2 statistical model to come up with the
3 predictability of failure than the non-funding
4 ratios. They were all statistically significant
5 and the weightings were derived and such.

6 So the next page shows the greatest
7 factors in terms of what's driving pricing in small
8 bank pricing. So the first is the leverage ratio
9 -- this is on average, so I want to talk about this
10 on average -- then we'll talk about how varied it
11 can be depending on your institution -- the leverage
12 ratio is the greatest contributor -- the Loan Mix
13 Index is the second largest, and the third is
14 weighted average CAMELS -- and these three are on
15 average by far the largest contributors to
16 determining the price of deposit insurance.

17 MEMBER SHETTLESWORTH: Patrick?

18 MR. MITCHELL: Sure.

19 MEMBER SHETTLESWORTH: Can you explain
20 the Loan Mix Index?

21 MR. MITCHELL: Sure. So the Loan Mix
22 Index, what we did, is we actually looked at

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1 charge-off rates across almost every category of
2 loan that's on the Call Report, so we have data for.
3 And we looked at the charge-off rates and they were
4 weighted by the number of failures in that year.
5 And so what's come out of that is there's weightings
6 each type of loan, so C&D has the highest weight,
7 C&I is the second highest -- I'm going to lose myself
8 after that in terms of rank ordering -- but they're
9 all based upon what we looked at, charge-off rates
10 during the time of stress, and that's how it's
11 determined. And then what it does is simply take
12 a look at your proportion of loans that are in those
13 types of assets and it uses that multiplier to come
14 up with a number that in and of itself isn't going
15 to make sense if you just look at it. It has to be
16 multiplied by the coefficient. It's not an
17 intuitive number in terms of C&D loans relative to
18 capital.

19 MEMBER SHETTLESWORTH: Can you share
20 with us our specific ratings on all these ratios or
21 is that all just inclusive of the overall assessment
22 rate?

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1 MR. MITCHELL: Could you repeat the
2 question?

3 MEMBER SHETTLESWORTH: The leverage
4 ratio is weighted, there's a certain category for
5 that; I'm just curious if your model will tell you
6 or you can share with us what our banks or other
7 insurance divisions what their rating is in each one
8 of these categories.

9 MR. MITCHELL: Oh, absolutely. So
10 it's all on the public website where you can punch
11 in your actual certificate and it will pre-populate
12 every one of these factors.

13 MS. ELLIS: Everything but CAMELS.

14 MR. MITCHELL: Oh, true. Good point.
15 Yes, you can do your own CAMELS.

16 MS. ELLIS: Yes, you can go to our
17 website and you can download our calculator and
18 it'll put all the Call Report data and you have to
19 insert your own CAMELS. If you want to look at
20 another bank, you can download all their public data
21 and pretend what their CAMELS might be.

22 (Laughter.)

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1 MR. MITCHELL: You can speculate.

2 MS. ELLIS: Yes, you can speculate and
3 whatever, play around.

4 MEMBER TURNER: Do you know what
5 weighted average CAMELS means? I understand
6 CAMELS obviously, but weighted average?

7 MR. MITCHELL: Right, each one of the
8 components is weighted; it's going to have a
9 different weight. So management has a higher
10 weight than liquidity. I'm forgetting asset
11 quality has a higher and capital --

12 MS. ELLIS: Capital assets -- capital
13 and management I think have the highest weight and
14 then asset quality and liquidity.

15 MR. MITCHELL: Right, and asset
16 quality, liquidity.

17 MS. ELLIS: It was a way of rather of
18 using -- and this was in the old system too -- rather
19 than just using a composite, it was a way to get a
20 little more granularity, because you know,
21 composite two -- I don't know, a great degree of
22 difference sometimes in one composite two, versus

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1 another -- so using the components was another way
2 of teasing out some of those differences in risk,
3 and then weighting management and capital and
4 assets heavier than the other is another way of
5 getting more granularity.

6 MR. MITCHELL: Those weightings are the
7 same that were in the previous rule, so those
8 ratings have been pretty consistent over time.

9 Sure.

10 MEMBER HARTINGS: The leverage ratio,
11 what's the tiering of that? Do you know where it
12 affects you -- is that at 4 percent, 6 percent?

13 MR. MITCHELL: So assuming you're
14 well-capitalized -- actually, it doesn't matter --
15 anyways, let's assume it doesn't matter -- assume
16 you're well-capitalized, it really is every
17 incremental dollar of capital or incremental
18 improvement in the leverage ratio will result in a
19 lower assessment, all else equal.

20 MS. ELLIS: But don't we have a floor?
21 I thought it was like 8 percent. If you're below
22 well -- all right, you're saying if you're below

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1 well-capitalized --

2 MR. MITCHELL: No, right. So --

3 MEMBER HARTINGS: So once you're
4 well-capitalized you're at the minimum?

5 MS. ELLIS: Yes, once you're
6 well-capitalized.

7 MEMBER HARTINGS: And then anything
8 below well-capitalized is dollar for dollar?

9 MR. MITCHELL: So they all work
10 together. And so it simply takes, if you're 8
11 percent -- let's say you increase your capital to
12 9 percent -- you hold everything else equal and
13 let's assume you're not in the floor or the ceiling
14 in terms of 3 or 30 -- so let's assume you're 5 basis
15 points and you went from 8 percent to 9 percent, that
16 will result in a lower assessment rate, all else
17 equal. The same if you were at 8 percent and your
18 capital lowers to 7 percent and nothing else
19 changes, it will result in a higher assessment rate.
20 So it is a multiplier. The interesting thing about
21 -- if you want to look at it and do a pro-forma, you
22 can actually change yours online; you can say what

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1 if I change my capital, how would my assessment rate
2 change, you could actually show what that would do.

3 If it doesn't make sense --

4 MEMBER SCULLY: Jack, was your
5 question, like if you're at 12, do you get a lower
6 assessment than if you're at 10?

7 MR. MITCHELL: You do all else equal.

8 MEMBER SCULLY: Yes, all else equal.

9 MR. MITCHELL: But it doesn't mean
10 you're at 3 basis points because it's going to look
11 at all the other factors. If you had really high
12 growth and/or you have low income and you have a
13 risky loan mix, that doesn't mean you're going to
14 be at the floor of those. It's just one component.

15 MEMBER HARTINGS: Well, if I'm at 12
16 and I go to 14, that will lower my --?

17 MR. MITCHELL: Yes, assuming, again,
18 you're at a 3, assuming you're at a 4.

19 MEMBER SCULLY: Your shareholders may
20 not like it...So Diane knows I'm going to say this
21 is my last meeting and I'll beat this dead horse one
22 more time.

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1 MS. ELLIS: Yes.

2 MEMBER SCULLY: But the fact that the
3 Loan Mix Index is the second most important
4 variable, even above CAMELS, just suggests to me
5 that at some point if you ever reconsider the
6 weighting, I mean you're penalizing banks that have
7 a certain business model, because it is ADC, C&I and
8 I think CRE is --

9 (Simultaneous speaking.)

10 MEMBER SCULLY: If you're a commercial
11 bank, my concern has always been since the first
12 time I saw this formula, poor Diane has to listen
13 to this every time.

14 MS. ELLIS: That's okay. You're not the
15 only one.

16 MEMBER SCULLY: But this proves if it's
17 the second largest factor that banks with certain
18 business models, despite how well they execute on
19 that business model, vis-a-vis their CAMEL ratings,
20 are being penalized versus banks that have
21 different business models. And I understand the
22 history during the recession and so on, but I just

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1 want to go on record as saying it's a penalty for
2 having a certain business model.

3 MR. MITCHELL: All else equal, I think
4 that's true. I mean, you might also have
5 additional -- you might also hold/retain additional
6 capital or other things that would get reflected,
7 and leverage ratio, and also non-performing loans.

8 MEMBER SCULLY: I shouldn't have to do
9 that unless you tell more openly that's what I
10 should have to do.

11 MR. MITCHELL: Well, okay.

12 MEMBER SCULLY: And given that they're
13 all 100 percent risk ratings, I would argue that if
14 you're suggesting I should have a different
15 leverage ratio because I'm a commercial bank, then
16 why are they at 100 percent risk rating rather than
17 125 percent risk rating, which would be more
18 consistent with that theory that business banks are
19 always riskier than others. So I just --

20 MR. MITCHELL: Sure, okay. I mean, I
21 think one of the challenges always, always true of
22 coming up with a pricing system that is pricing over

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1 5,000 banks and using statistical analysis.

2 MEMBER SCULLY: But look at -- and I'm
3 going to just keep it up, I'm sorry -- there are
4 eight majors here, and first of all, there's the
5 CAMELS rating which to me is your opportunity, you
6 finding you've really hit a granular level,
7 examined a bank, you've give management a certain
8 weighting; that's lower than Loan Mix, it's lower
9 than non-performing loans, it's lower than OREO. I
10 mean, intuitively it would seem to me that when you
11 see the results of the formula and they suggest that
12 that's the second most important thing, it might
13 cause you to think do we have the factors weighted
14 correctly. That's all.

15 MEMBER K. KELLY: I'll try to add a
16 little color, if I'm hearing you correctly, Mary;
17 she's basically saying if I -- and I'm going to put
18 it in automobile speak -- if I buy a corvette at 18,
19 let me know the insurance is going to be much higher
20 than if I buy a Crown Victoria, regardless if I'm
21 50 or 18. So the point I'm trying to make is, I
22 think the question is if my business model is more

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1 of a Corvette, I pay a little bit more of a premium
2 versus if it's a Crown Vic, meaning a slower pace.
3 And relative to those other factors that I think I
4 have control over when I get behind the wheel, maybe
5 my insurance rates deal is not reflected even though
6 I'm a more conservative driver. It's kind of what
7 I'm hearing you say; if not, tell me now.

8 MEMBER SCULLY: Yes, it's a basic premise
9 that I have that there are certain things that
10 indirectly will cause a reallocation of capital
11 because these obviously, ultimately affect your
12 profitability; therefore, it affects your
13 attractiveness to investors.

14 MEMBER K. KELLY: That's right.

15 MEMBER SCULLY: So it is an implicit
16 reallocation of the capital to banks that have a
17 certain, or away from banks that have a certain
18 business model.

19 MEMBER K. KELLY: That's correct. And
20 so the question that I would have in following up
21 Mary here, is to help us to understand which of those
22 business models is a Vette versus which one looks

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1 more like a Crown Victoria.

2 MS. ELLIS: Well, I think this is sort
3 of doing that, right?

4 MR. MITCHELL: I think so. I mean,
5 that's one thing we hope to have very transparent.
6 Again, you can disagree, but I mean even in the
7 Loan Mix Index it shows to your point right or wrong,
8 we can agree whether we should or not, but it shows
9 that C&D is going to contribute more. We actually
10 rank order them in terms of loans and then we also
11 show the effect of increasing leverage, either
12 increasing or decreasing your leverage. Your
13 asset quality is a little more reflective of
14 previous decisions, so that's going to just get
15 reflected, but --

16 MS. ELLIS: I think if you fill out that
17 profile, you would find that a bank heavily loaned
18 up in C&D loans with thinly capitalized, growing
19 rapidly with brokered deposits, they're going to be
20 way -- that's the model that's going to get charged
21 a lot in this system.

22 MEMBER K. KELLY: Got it, thank you.

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1 MEMBER DONNELLY: Just a question on
2 the modeling you have on the website, and before I
3 throw rocks from this side of the table. Now, is
4 that model -- because I played around with it -- is
5 that model going to be something that I use as a tool
6 or is it just something that's out there? I hate
7 to be so direct but I'm going to be, because this
8 is a pretty important piece, I think for everybody
9 up here, it's an important piece to calculate, and
10 if the rules are the rules, we need to know what they
11 are. And go into budget, can I take that calculator
12 online and I can depend on that other than the
13 subjective -- well, management is subjective.

14 MR. MITCHELL: Yes, I think that's the
15 primary purpose for this is so that you can plan --

16 MEMBER DONNELLY: Planning, you're
17 going to have to get me with 95 percent of my -- I'm
18 using that number, I don't want to pin you -- or
19 maybe I do want to pin you down -- but to 95 percent
20 accuracy on what my --

21 MR. MITCHELL: I mean, to the extent you
22 were able to project accurately what your balance

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1 sheet and these components are going to look like,
2 it's 100 percent accurate, because you know your own
3 CAMELS rating. So it's only subject to that
4 uncertainty; otherwise, it's completely
5 transparent and you can see the absolute --

6 MEMBER SCULLY: And I would vouch for
7 that; it is totally transparent, totally
8 predictable, but what this does is it says it's not
9 just me, it's saying that in the entire industry
10 that has a very significant impact.

11 MR. MITCHELL: So I do want to talk
12 about that a little bit, this is on average, and to
13 your point there are some institutions where there
14 are other factors that are a greater weight. So if
15 you're a rapid -- if you have really rapid growth
16 and you're 50-60 percent, that very well may be your
17 top factor. Meanwhile, if you're making loans or
18 you're less loaned up and you're making loans that
19 we view as lower risk in the Loan Mix, then that Loan
20 Mix Index may be lower than your contribution from
21 your CAMELS and others.

22 MEMBER SCULLY: But on average.

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1 MR. MITCHELL: This is on average rank
2 order.

3 MEMBER SCULLY: On average business mix
4 is the second greatest factor, above CAMELS
5 ratings.

6 MS. ELLIS: Correct.

7 MEMBER SCULLY: Counterintuitive.

8 MS. ELLIS: Very correct.

9 MEMBER WILLIAMS: You know, I
10 understand what you're saying here, but is there --
11 apparently there isn't any granularity, you don't
12 get any more granular into that mix. For example,
13 we talk about management's piece in this being an
14 important factor, and management's piece in
15 controlling and managing loan portfolios is an
16 issue as well. Example, ADC; now, I can speak to
17 some specifics, but you look at a company or a bank
18 that has ADC, that's a category, but if you
19 internally manage it to where they have a maximum
20 of 7-1/2 percent of that is acquisition, another
21 7-1/2 percent maximum development, and the rest is
22 vertical construction with a 6-month tenor and

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1 you're carrying extra capital; to me that's a
2 portfolio risk factor that's a lot less than an ADC
3 typical number you're using. So is there any way
4 to take into consideration the management controls
5 on the loan portfolio for those who have a business
6 plan -- ours is the same way, it's a business bank
7 -- but the controls are tighter than I've seen with
8 a lot of large national banks that we've worked at.
9 So I'm just saying granularity is an issue too; I
10 don't know how you take that into consideration as
11 you put these prices together.

12 MR. MITCHELL: One of our biggest
13 challenges, and we try to remove effectively
14 subjectivity from this, we try and use the data that
15 we have, and we're limited by the granularity of the
16 Call Report. I'm sure you're not suggesting we get
17 more granular on that.

18 (Laughter.)

19 MR. MITCHELL: So it's a challenge,
20 admittedly; and this is where I said we're pricing
21 over 5,000 banks with one model. It's really
22 required and it goes back to as an insurance company

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1 sometimes you're looking for certain predictors
2 that -- I mean, could you have false positives, yes,
3 could you have false negatives, absolutely -- but
4 what we have seen is this, the pricing model that
5 we put in place was a significant improvement over
6 the CAMELS model. And part of that, one of the new
7 components, one of the significant new components
8 was the Loan Mix Index. I mean, one of the other
9 things we're trying to do, and again, we can argue
10 whether it's good or bad, is to look more forward
11 and make sure we're pricing for risks as they're
12 incurred. Those risks may or may not be realized,
13 but as they're incurred we want to make sure as an
14 insurance company we're charging for those risks as
15 best we can.

16 MEMBER TURNER: I do think -- and at the
17 risk I get shut down by my colleagues -- I do think
18 the Call Report is overly broad in a couple of
19 categories and you miss the risk a little bit -- and
20 as I've said, we acquired five banks -- we probably
21 from the FDIC we looked at, I don't know, 30 or 40
22 of them, so we have a fairly good feel of the kind

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1 of problems that cause that created failure in those
2 cases. And not all ADC loans are created equally.
3 If you're financing a senior care facility or an
4 office building that's pre-leased, or a
5 multi-family project that's got 30, and those
6 things have 30-35 percent equity, that's a totally
7 different risk profile than financing a piece of
8 ground 100 percent for somebody that's hoping to
9 sell it down the road. And those are the problems,
10 at least in the banks that we ultimately acquired,
11 those are the kind of loans that created big losses;
12 it wasn't the former loans. And I agree with Mary
13 Ann to a large extent, I think you're not taking --
14 as you weight the loan mix so heavily you're not
15 taking differences in underwriting into account,
16 too, and you have the ability to do that because you
17 come in and examine us every year. And so if you
18 have a loan mix that by this formula would indicate
19 a little higher risk, but you come in and you have
20 no bad comments about the bank's asset quality,
21 they're one rated asset quality, it seems like you
22 have an ability to maybe get a little bit more

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1 granular and a little bit more specific to a given
2 institution. So I kind of agree, I think that's
3 what you were saying, Mary Ann; I kind of agree.
4 And it may be a question of whose ox is being gored
5 because we have the wrong kind of loan mix, I can
6 tell you that for sure. And so I'm sure we're
7 paying a little bit higher assessment as a result.

8 MR. MITCHELL: So I would say -- and I
9 understand your point -- I mean, I would say at the
10 very least your asset quality rating certainly is
11 included in there and is weighted.

12 MEMBER TURNER: Right, yes.

13 MR. MITCHELL: While it's third, it's
14 not insignificant. These three all on average
15 apply.

16 MEMBER TURNER: We just wish it was
17 first.

18 (Laughter.)

19 MEMBER HARTINGS: Can I just ask one
20 other question about the small bank assessment
21 graph you showed us? You talked about once the \$10
22 billion and over assessment falls off and goes back

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1 to about 20 percent, that's your best estimate
2 today, is that the percentage of liabilities that
3 those small banks have in the -- and is it 20 percent
4 today?

5 MR. MITCHELL: It's close, it's roughly
6 close.

7 MEMBER HARTINGS: Like close more or
8 roughly close less?

9 MR. MITCHELL: No, I think it's
10 actually a little bit higher right now. But it
11 hasn't always. I mean, a couple percentage. I
12 don't have exact so I don't want to --

13 MEMBER HARTINGS: So it pretty much
14 runs that liability --?

15 MR. MITCHELL: It stayed roughly in
16 line with the intention.

17 MEMBER HARTINGS: Okay, thanks.

18 MR. MITCHELL: So the last slide --
19 maybe this will be positive, we'll see.

20 (Laughter.)

21 MS. ELLIS: I think it's an act of
22 goodness.

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1 MR. MITCHELL: Right, exactly. Is
2 again, talking about credits. So when the reserve
3 ratio hits 1.35, then as I noted, then the large
4 banks will stop paying surcharges. And once we hit
5 the 1.38, credits will be applied to small banks.
6 And those credits will offset to the extent whatever
7 credits you receive, will offset in whole any of
8 your assessments until they're exhausted. So we
9 expect depending on your situation two to four
10 quarters where you'll have your entire assessment
11 offset. And it also depends on when we hit; we do
12 expect either third or fourth quarter this year we
13 will hit 1.35. And then you will receive -- you'll
14 either see the amount of credits applicable to your
15 institution on your invoice or we will separately
16 notify; it all just depends a little bit on timing.
17 Obviously, we need to get invoices out, but we need
18 to make sure we're also, we're accurately and
19 closely calculating the amount of credits. So
20 you'll either receive it in your invoice or you'll
21 receive it shortly after showing the amounts that
22 are due to your institution.

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1 MEMBER TURNER: That's positive.

2 MR. MITCHELL: It is positive.

3 MEMBER TURNER: So is that where you
4 hope to keep it at 1.35, the fund?

5 MR. MITCHELL: Well, that's our minimum
6 reserve ratio, so right now our designated reserve
7 ratio, the long-range target is 2 percent. But
8 what we anticipate after we hit 1.35 with the rates
9 that I've shown you, we expect very slow but steady
10 growth. And that's why we have to get above 1.3 --
11 well, in the rule we placed it at 1.38 to allow a
12 little bit of breathing room. If we were to -- for
13 some reason there were a high amount of insured
14 deposit growth and/or combined with a failure and
15 we were to go below 1.35, we would actually go back
16 -- we would have to go back into a restitution plan
17 once we go below 1.35. So it's important for us to
18 hit 1.35, grow a little bit, provide ourselves some
19 cushion, and that's why the delay until 1.38.

20 MEMBER HANRAHAN: Patrick and Diane,
21 thank you for the explanation. At the risk of
22 minimizing some of my colleagues' comments about

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1 potential model imperfections, which they're
2 always in debate in any model, right?

3 MR. MITCHELL: Absolutely.

4 MEMBER HANRAHAN: I think this is
5 overwhelmingly good news. Don't mistake me for a
6 full-fledged fan of the Dodd-Frank Act, but I was
7 really happy that the assessment base got changed
8 from deposits to liabilities. I was really happy
9 that the increase from 1.15 to 1.35 got put on the
10 backs of the big banks. And any way you look at
11 these numbers our cost of insurance has plummeted
12 over the last several years. So I think it's 99
13 percent good news and I appreciate the explanation.
14 Thank you.

15 MEMBER K. KELLY: I'll conclude my
16 comments by saying good job in what you presented.
17 I think it's apparent that you stated that there are
18 statistical analysis that have come up with this
19 model - you've done regressions on it in a way that
20 you can clearly identify it to do more granularity
21 and probably not get the same level of correlation.
22 But what I thought I heard you say at the very end

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1 is there's kind of the Allstate model - we're
2 getting cash back.

3 (Laughter.)

4 MR. MITCHELL: That's right; I hadn't
5 thought about it. I'm going to have to remember
6 that one.

7 CHAIRMAN McWILLIAMS: But only if
8 you're a good driver.

9 (Laughter.)

10 MR. MITCHELL: Actually, in this case
11 we're indifferent as long as you're still
12 surviving.

13 (Laughter.)

14 MEMBER K. KELLY: Thank you.

15 MR. MITCHELL: And again, I just
16 reiterate, there's assessment hotline if you have
17 any questions, if you want to go through any of your
18 specifics or any specific questions, please reach
19 out. We have people that this is what their job is
20 to do, to make sure you're clear on what's driving
21 your institution's rates.

22 MR. DAVIS: Great. Well, that brings

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1 us up to another break. So we are scheduled to
2 break from 2:30 to 2:45. We're about ten minutes
3 ahead. My suggestion would be, if folks don't
4 disagree, to come back at 2:35 instead of 2:45; that
5 way either we wrap early or you have more time for
6 the last session that a lot of people have talked
7 about.

8 So we'll have a 15-minute break, be back
9 here at 2:35.

10 (Whereupon, the above-entitled matter
11 went off the record at 2:20 p.m. and resumed at 2:37
12 p.m.)

13 MR. DAVIS: Okay, I think we're ready
14 for our last session of the day. For this session
15 it is apparently the most anticipated session from
16 what I gathered earlier.

17 We're going to discuss the interest rate
18 restrictions applicable to less than
19 well-capitalized banks. We have Associate
20 Director Rae-Ann Miller back and joining her is
21 Vivek Khare, counsel from our Legal Division. And
22 I'll turn it over to Rae-Ann to start.

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1 MEMBER TURNER: They brought a lawyer.

2 MS. MILLER: Given the level of
3 excitement I thought it was the safest approach.

4 CHAIRMAN McWILLIAMS: Patrick is
5 bringing a bodyguard.

6 MS. MILLER: Vivek and I are both from
7 New Jersey as is David. There's a saying there you
8 can't win for losing so we'll start the presentation
9 with that.

10 So we wanted to talk to you guys today
11 about interest rate restrictions, statutory
12 interest rate restrictions. We touched on it a
13 little bit this morning. I will say that the
14 conversation was very helpful to us and I have taken
15 down some notes about what the market is doing and
16 really how it's changed.

17 And it's changing right now. I found
18 that Joe's conversations about -- I think it was Joe
19 -- mentioned doing a special and how you haven't
20 done it in a long time. Was that you or was that
21 Danny?

22 MEMBER TURNER: We have done specials.

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1 But you know, I think what I was talking about was
2 we hate to reprice our entire portfolio where you
3 can be a little more targeted with a brokered
4 offering.

5 MS. MILLER: So anyway, so as we go
6 through I think a lot has changed and is changing.
7 I mentioned this morning that we're going to be
8 doing a broader rulemaking on brokered deposits in
9 general and rate restrictions and so this
10 conversation will be helpful for us there. And
11 certainly when we do that we would welcome your
12 comments.

13 So, in looking at the statutory interest
14 rate restrictions and we put in your package a few
15 things. We have the last time we changed the
16 methodology in 2009 for calculating the rate
17 restrictions. An article we did a couple of years
18 ago.

19 And then I just put a little chart that
20 I'll refer to later tracking over time what the rate
21 restrictions have done.

22 So, just a little background as to why

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1 we have statutory rate restrictions to begin with.
2 So going back in time one of the things we do when
3 we look at exam policy is how did we get here. And
4 so we go back in time all the time and look and see
5 why things were put in place.

6 And I have old manuals in my office and
7 we have them in the library. I kind of go
8 downstairs every now and again and look at our
9 history.

10 And you start seeing references to
11 brokered deposits and high rate deposits, rate
12 sensitive deposits probably around in the nineteen
13 seventies.

14 And if you remember right around late
15 sixties, early seventies negotiable certificates
16 of deposit were a new product at that time. And
17 people, globalization in financial markets in
18 general and people were seeking out rates and
19 seeking out ways to park excess funds at the highest
20 rate possible.

21 That was really the first time you
22 started seeing people going outside of their local

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1 bank to take cash balances and invest them. And at
2 the same time there was really a democratization of
3 the brokered dealers and people having brokerage
4 accounts and not just for the rich people.

5 You saw a lot of disintermediation, a
6 lot of globalization in money management. And you
7 start seeing that in exam instructions and annual
8 reports about the flow of funds.

9 So, along with that you started seeing
10 some issues. And I would agree with Joe that
11 certainly not all banks that have brokered deposits
12 are high rate deposits. In fact most manage those
13 just fine and it's part of an overall strategy.

14 But throughout time there is a linkage
15 between institutions that have used brokered
16 deposits and use high rate deposits for excessive
17 risk taking, excessive growth and those
18 institutions have cost us a lot of money on the back
19 end.

20 When you start going into the nineteen
21 eighties we had the banking and thrift crisis as you
22 know. Looking at the annual reports and some of the

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1 other reports that were produced regarding the
2 crisis as that was unfolding many of the failures
3 and problem institutions had heavy levels of
4 brokered deposits.

5 If you remember Penn Square was a famous
6 large spectacular failure. Over 80 percent of its
7 deposit base was basically brokered and high rate
8 funds.

9 And what would happen was there was a
10 pattern. The institution would basically call up
11 and get all the funds it wanted, do high risk deals
12 with those funds, get in trouble and then get more
13 funds to try and grow out of its problems.

14 And at the end of the day those were
15 very, very costly to us. Acquiring banks typically
16 don't pay at all for brokered deposits and in some
17 cases we actually do not even pass those. We have
18 to pay those off. So that was sort of the history
19 of the problems.

20 So, in 1989 with FIRREA, Congress
21 basically instituted restrictions on brokered
22 deposits and high rate deposits. And at the time

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1 when you look -- and Vivek has looked a lot more at
2 the congressional history than I have, but the issue
3 with the high rate deposits was that banks were
4 basically serving as their own money desks.

5 Even if you had brokered deposit
6 restrictions the concern there was well the bank
7 will just assign some employees to just dial for
8 dollars basically and call and get as many deposits
9 as they want.

10 So they instituted two restrictions,
11 brokered deposits and high rate deposits.

12 So those have been in place since 1989.
13 And then in 1991 with FIRREA the restrictions were
14 then linked to the prompt corrective action
15 framework.

16 So you had automatic restrictions kick
17 in. And it's one of the first things that kicks in
18 basically when an institution falls below
19 well-capitalized.

20 So the purpose of the restrictions
21 basically are threefold. I think somebody
22 mentioned our report that we had done after the

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1 Dodd-Frank Act was passed on -- it's called the Core
2 and Brokered Deposit Study and we talk about
3 basically three things that the brokered deposit
4 restrictions and the rate restrictions are there
5 for.

6 Number one is to prevent rapid growth on
7 the upswing. Rapid growth that's not well absorbed
8 by the institution.

9 So what we saw in this last crisis was
10 institutions growing very, very fast with brokered
11 deposits, with high rate deposits and imprudently
12 investing those funds in mostly CRE but oftentimes
13 CRE and out of area CRE and things that it probably
14 didn't have experience in.

15 The second thing is volatility. This
16 is what we hear often as well. It's hot money.
17 This money is not hot. How can it be a brokered
18 deposit if it's not hot money?

19 Well, especially with the deposit
20 insurance limit at \$250,000 not all brokered
21 deposits are necessarily hot money or high rate
22 deposits or hot money. They might not be volatile

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1 because the person might just be seeking deposit
2 insurance. But again how did they use them on the
3 way up.

4 And then the third piece and the reason
5 brokered deposit and high rate restrictions are in
6 place is franchise value. What are those deposits
7 worth if the bank fails? And brokered deposits and
8 high rate deposits really don't fetch the same type
9 of -- if anything the same type of money when the
10 bank fails.

11 So I was going to turn it over to Vivek
12 to talk a little bit about the legal framework and
13 how the law and the regulations that we have
14 interact.

15 MR. KHARE: Thanks, Rae-Ann. Yes, I'm
16 going to get into the legal framework around the
17 rate restrictions and hopefully that will provide
18 you with some context when we get into our
19 discussion.

20 So as Rae-Ann mentioned the statute, the
21 first thing I'll talk about, section 29 of the FDI
22 Act was enacted in 1989 via FIRREA and it set forth

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1 two types of restrictions. The first restriction
2 is that less than well-capitalized institutions may
3 not accept, renew, or roll over brokered deposits
4 unless they receive a waiver if they're adequately
5 capitalized.

6 And the second restriction which is
7 going to be our focus here today is that less than
8 well-capitalized institutions are limited or
9 restricted on the amount of interest that they may
10 pay.

11 So the statutory interest rate
12 restrictions are based upon capital category and
13 can be summarized as follows.

14 Well-capitalized institutions can pay
15 any rate they wish on any sort of deposit.
16 Adequately capitalized institutions generally may
17 not pay rates of interest that are significantly
18 higher than the rates offered in the institution's
19 normal market area or the national rate.

20 And undercapitalized institutions
21 similarly may not pay rates of interest that are
22 significantly higher than either of the following,

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1 the rates in the institution's normal market area
2 or the rates in the institution's market area from
3 which deposit is accepted.

4 So as you can see the statute sets a
5 general framework but it really doesn't provide
6 some key details. For example, it doesn't define
7 some of the terms that I just mentioned such as what
8 does it mean to provide a rate that is quote,
9 "significantly higher," and what exactly is an
10 institution's market area.

11 And of course most importantly what is
12 the methodology that gets you the national rate.

13 So this brings us to our rulemaking and
14 then through two regulations -- one in 1992 and
15 again in 2009. The FDIC has implemented these
16 statutory requirements and defined these key terms
17 after engaging with the industry and other key
18 stakeholders.

19 I'll start in 1992 the FDIC defined the
20 term "significantly exceeds" as 75 basis points.
21 This would provide IDI subject to the rate caps an
22 opportunity to compete for funds within markets by

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1 paying 75 basis points over the national rate for
2 their local market rate while also restricting
3 their ability to attract funds by paying rates
4 significantly higher in accordance with the statute
5 than prevailing rates in their respective markets.

6 As part of that '92 rulemaking, the FDIC
7 after review of multiple options during the
8 rulemaking process calculated the national rate as
9 120 percent of the Treasury yield curve and 130
10 percent of the yield curve for wholesale deposits.

11 The FDIC at the time decided to couple
12 the national rate with the Treasury yield curve
13 because it allowed for greater flexibility should
14 the spread to Treasury securities widen in a rising
15 interest rate environment. And most notably at the
16 time we just didn't have the data. We didn't have
17 reliable accurate data that was timely whereas
18 Treasuries were being provided on a daily basis.

19 And so for many years the definition
20 functioned reasonably well. The Treasury rates
21 tracked closely with the rates on deposits so
22 troubled banks could generally pay up to 75 points

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1 above the Treasury yield curve.

2 However, leading up to the recent
3 financial crisis the rates on certain Treasury
4 obligations lowered significantly compared to
5 deposit rates and consequently the national rate
6 that was pegged to the Treasury yield was
7 artificially low thereby restricting access to even
8 market rate funding for less than well-capitalized
9 banks.

10 In response to this issue and as part of
11 the 2009 rulemaking the FDIC redefined the national
12 rate as what it is today, a simple average of rates
13 paid by all IDIs and branches for which data are
14 available.

15 This was done again primarily because
16 data was finally readily available to provide a true
17 objective national rate.

18 Today the FDIC gathers national rate
19 information from up to 80,000 main office and branch
20 locations and publishes specific product rates
21 weekly on its website.

22 The published account types and

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1 maturities are those most commonly offered with two
2 rates provided for each maturity, one jumbo, one
3 non-jumbo.

4 In addition and as part of that 2009
5 rulemaking the FDIC developed a presumption that
6 the prevailing rate in any market would be the
7 national rate.

8 This approach recognized with the
9 increasing prevalence of internet deposits and
10 internet advertising of deposit rates, price
11 competition for deposits has become more national.

12 Moreover, this approach recognized and
13 avoided the considerable practical difficulties
14 that can exist with trying to figure out the
15 boundaries of a larger institution's normal market
16 area and then attempting to dissect the prevailing
17 rates paid within that area.

18 While the 2009 rulemaking presumed the
19 national rate applied across the board for less than
20 well-capitalized banks, the FDIC also provided a
21 rebuttable presumption for banks that sourced
22 deposits solely from their local market area.

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1 This was known kind of as a community
2 bank exception. So if an IDI believes that the
3 prevailing rates in its local market area are higher
4 than the national rate they could come to our FDIC
5 regional office, provide evidence to the regional
6 office that the local rates are higher than the
7 national rate and then the institution will be able
8 to pay 75 basis points over their prevailing local
9 market rate.

10 In evaluating this evidence that the
11 banks provide, the FDIC can use segmented market
12 rate information and also can consider evidence as
13 to the rates offered by credit unions if the IDIs
14 are competing against credit unions in their local
15 market area.

16 Finally, the FDIC may consider evidence
17 that the rates are based on certain deposit
18 products, such as NOW accounts, and whether those
19 accounts differ from rates on other products such
20 as MMDAs.

21 So this option has given some
22 flexibility to community banks that are competing

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1 in a local market area and particularly now because
2 we see a little bit of a crunch with the national
3 rate.

4 So that's where we are today. We have
5 undertaken these two rulemakings to try to clarify
6 and update our restrictions but with that we still
7 see some new issues and see some reemerging issues
8 which Rae-Ann's going to talk about.

9 MS. MILLER: So yes. We put a chart in
10 here on the last page of your packet for our
11 presentation. I just want to refer you to that.

12 And what this depicts here, this is a
13 wholesale CD, a 12-month CD product. And what we
14 tried to do was show you what the rate caps look like
15 under the old methodology which is the red dotted
16 line if we were to have maintained that.

17 The new methodology that we instituted
18 effective in 2010 is the green dashed line.

19 And then the blue line depicts sort of
20 a proxy for high rate payers. And this is from a
21 listing service that you've probably heard of, just
22 the top 10 payers. To stay competitive and to get

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1 wholesale funds you really have to be one of the
2 first names that folks see.

3 So you can sort of see how we -- the high
4 rates CDs sort of tracked for a long period of time
5 the Treasury rate. We didn't shade recessions, we
6 probably should have, but in the early two thousands
7 you'll see that Treasury dips down below a little
8 bit. That's probably a rush to safety.

9 And then we kind of track again the shape
10 of the Treasury until the 2007 disruption when a
11 huge rush to safety really drove yields down on
12 Treasuries.

13 So at that time I didn't have this job
14 but at the time we were processing hundreds of local
15 rate determinations, the community bank
16 presumption that Vivek talked about.

17 Banks were running -- that were less
18 than well-capitalized that may have had some
19 viability issues were running out of options
20 because they were running into a liquidity crunch
21 because when the rate restrictions crunch you they
22 will crunch you fast and that was what was

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1 happening.

2 So we went out, made this change and as
3 you can see the green dotted line which is the
4 national rate based on this survey. And we get this
5 survey from a company. We talk about the name of the
6 company on the website and publish it weekly.

7 And it is indeed -- it's a survey of all
8 banks and branches that offer the particular
9 product. So a one-year CD is probably one of the
10 most common products. I think it has something
11 like 60,000 votes if you will about banks and
12 branches that offer them in order to hit the
13 national rate.

14 So you'll see here this green line for
15 a number of years after the crisis was above the blue
16 line. So banks that were less than
17 well-capitalized were able to access funds from
18 listservs or other high rate sources without much
19 problems.

20 They might have been shut out from the
21 brokered deposit market, but they could still get
22 high rate deposits.

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1 Well, that changed in 2015 when the Fed
2 started raising rates. And what happened at that
3 time was institutions could no longer compete. The
4 rate restrictions started -- the rate caps started
5 becoming binding on those institutions.

6 And so we did have a few failures and
7 problems of institutions that sort of caught them
8 suddenly. We hadn't been dealing with rate
9 restrictions for a number of years.

10 So we certainly -- one of the things Dave
11 said early in the presentation was and maybe some
12 others did was, "Gee, we have started focusing on
13 the right side of the balance sheet."

14 Well, as examiners we had not focused on
15 the right side of the balance sheet. We were
16 dealing so much with the left side and with the
17 hangovers of CRE and other problem loans that we
18 sort of lost our evaluative focus on the right side
19 of the balance sheet.

20 But we had these few institutions that
21 sort of be-bopped along and were able to stay alive
22 this way but really did not have prospects. And a

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1 few failed and cost some money and we were lucky with
2 a few others.

3 Sort of reinvigorated our training of
4 examiners. Remember that this is an issue when
5 you're talking with bankers you need to make sure
6 they understand that this is an issue.

7 We did this article as well to remind
8 institutions.

9 So flash forward, that's sort of 2015,
10 2016. As the market has continued to rise, the
11 national rate has come up a little bit but not very
12 much. And so we are thinking of ways, things that
13 we could do and questions that we could ask to see
14 whether the methodology that we're using is still
15 the appropriate one.

16 It's certainly not the only one. I keep
17 picking on you but I would disagree with you that
18 there's something wrong with it. I think it's a
19 mathematically accurate calculation. Now whether
20 it's the only one or the most appropriate one
21 remains to be seen. So something certainly that
22 we're looking at and would be interested in with our

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1 rulemaking later this year.

2 So I think with that maybe we'll pause
3 and see where you guys are.

4 MEMBER SHETTLESWORTH: From an impact
5 standpoint, do you see this rate cap impacting
6 larger institutions or is this more the smaller
7 institutions? I'm concerned that there's a
8 potential of unfairness out here.

9 I understand why we're managing this,
10 but the large banks have a lot more access to a lot
11 different types of liquidity than I do. So I'm just
12 wondering if this is overly penalizing the small
13 banks.

14 And I also realize it's based on what the
15 deposit insurance fund lost with small banks. But
16 if the largest banks wouldn't have had a capital
17 injection we would have had -- their losses would
18 have wiped out.

19 MS. MILLER: There is a reason for the
20 rate restrictions. Failures are costly. We don't
21 want banks trying to grow out of their problems.

22 But that being said the reason why

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1 there's not significantly over the prevailing rate
2 is those banks do have a chance to compete if they
3 are having a problem to try and find capital, to try
4 and work out of their problems without aggressively
5 growing.

6 I don't know that it necessarily
7 penalizes small institutions. But the way it has
8 been calculated has certainly not been helpful if
9 that's any.

10 MEMBER SCULLY: I think one of the
11 concerns, maybe two of the concerns is what are the
12 appropriate indices. And is it really possible to
13 say there's a national cap as opposed to putting
14 institutions into regions where there are great
15 differences that can be impacted by competition.

16 But I think the reason that so many
17 people are focused on this right now -- because if
18 everybody thought this was only going to apply to
19 less than well-capitalized institutions I think
20 most people would say, "Oh well, that's never going
21 to be me, I'm not worried about that."

22 But the danger is that this definition

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1 of an instrument that carries a rate above a
2 national cap will at some point be swept into this
3 evolving definition of high volatility deposits.

4 There's already a lot of discussion --
5 not any kind of even official guidance on that --
6 but I think a lot of us when we've had recent
7 examinations on the liquidity side have heard about
8 this high volatility deposit definition.

9 Not to beat my business model drum
10 again, but if you're a commercial bank and you've
11 got a lot of commercial deposits, you have a lot of
12 deposits that are over the FDIC insurance limit.
13 They're certainly what we would view as core
14 deposits, but they count as high volatility
15 deposits in these new definitions.

16 And so I think the overall concern is
17 does this category that we've always thought of as
18 only applying to troubled institutions now somehow
19 get swept into another category that could affect
20 all institutions.

21 And maybe the -- one's a suggestion,
22 move away from the national caps, but the other is

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1 more of a question to you in terms of does this then
2 become quite naturally something that's
3 extrapolated into oh, and this is also a high
4 volatility deposit because it's carrying an
5 interest rate that's significantly above a national
6 cap.

7 MS. MILLER: Can I add that you're also
8 in a metropolitan area that probably pays higher
9 rates.

10 MEMBER SCULLY: Well, we have a lot of
11 credit union competition. And I never know if IDIs
12 count. People insured by NCUA or only FDIC. If it
13 doesn't count NCUA, you're definitely not capturing
14 the highest rates.

15 MEMBER DONNELLY: Question. You made
16 a comment, Rae-Ann, and I appreciate it. I think
17 it's helped me on this because this is a concern of
18 mine.

19 The concern to the loss to the fund
20 because the brokered deposit has no value at the
21 sale, that is higher weighted than the liquidity
22 that they'll provide me before I close. Is that an

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1 accurate statement? And I hope that makes sense.

2 MS. MILLER: No, it does not so can you
3 repeat the question?

4 MEMBER DONNELLY: Sure. I heard you
5 say that the brokered deposits have no value at the
6 sale. That's after the bank's been liquidated.

7 So that seems to me to be a higher value
8 to the FDIC versus the liquidity available to the
9 institution before it fails.

10 MS. MILLER: I don't think that's quite
11 fair to say that but I think that's what Mary Ann
12 is saying by this term which is not an official
13 definition of high volatility but I agree that as
14 examiners we have probably relied on that too much.
15 And we're working on that certainly with the
16 instructions.

17 It's a balancing act because it does --
18 brokered deposit, high rate deposits are part of
19 many institutions' business model and used
20 appropriately and provide appropriate liquidity.

21 But the restrictions are there for a
22 reason and the reason is our history of having

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1 problems with them being used imprudently and not
2 getting the appropriate value when it fails. It's
3 not that one is more valuable than another.

4 MEMBER DONNELLY: And just from my
5 perspective coming in and playing cleanup is a whole
6 lot easier looking backwards and having 20/20 than
7 it is while you're there in the heat of the battle.

8 Seeing a bank that's funded with local
9 CDs at the highest part of the market, absolutely
10 the highest funding in the market when brokered
11 deposits are different than that.

12 And as soon as that institution gets
13 into trouble, those CDs run off just as fast as
14 anything else from a liquidity standpoint only, not
15 from a safety and soundness and can I sell it
16 tomorrow perspective.

17 That is so evident. As soon as you
18 lower those rates those things are gone. And then
19 the value has got to be lower when they're priced
20 higher than market and you can come in after the
21 sale, after the close and reduce that the one time
22 whatever that is.

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1 MS. MILLER: You make a good point. We
2 caught the tail end of Pat's presentation on the
3 pricing model. So although it's unusual for a
4 community bank apparently to be penalized for
5 brokered deposits it could happen.

6 But high rate deposits aren't
7 necessarily factored into that calculation.
8 That's something else for the rulemaking. Are we
9 hitting the right note there?

10 Certainly when we look just at cost of
11 funds and look at 90 percentile payers, 95
12 percentile payers they are as likely to fail as
13 institutions that are heavily reliant on brokered
14 deposits.

15 MEMBER HARTINGS: Can you answer the
16 question how do the credit unions pricing fit into
17 the IDIs? Is that part of it?

18 MS. MILLER: I can answer. Oh, you
19 want me to?

20 We don't calculate credit unions in the
21 national rate but community banks, or really any
22 bank. We call it the community bank exception

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1 because that's typically who uses it.

2 But if a bank is paying in its local rate
3 area a bank that's less than well-capitalized and
4 wants to show us evidence of where they are on the
5 rate-paying scale they can use credit unions as an
6 example. And often do.

7 MEMBER HARTINGS: And why don't you?

8 MS. MILLER: Well, you know, I think
9 going back in 2009 we didn't give a real good reason
10 as to why we didn't. I think perhaps at the time
11 we did not have the same ability to gather that data
12 with credit unions.

13 The service that we use is primarily a
14 bank gathering service but certainly again it would
15 be something that would be of interest. Certainly
16 when you look at the services and you want to find
17 the highest CD rate you will see credit unions
18 appear along that list with banks.

19 MEMBER MENON: You also use the rates
20 that are posted nationally by online banks like
21 Synchrony and banks like that?

22 MS. MILLER: So, the national -- no.

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1 The national rates are done through a service that
2 actually, I don't know if they call around or they
3 have a call-in sheet or whatever but they do all
4 branches and all offices regardless of whether
5 they're -- we don't just look at high rate payers.

6 And another thing that made me think
7 when you asked that question is, and this is why I
8 was asking Joe that question about specials is we
9 don't include special features. And I think in
10 this market something we were talking about before
11 we came in is the rate that's posted or the rate that
12 they might answer to you on for this company is the
13 12-month jumbo CD at 25 basis points. That's what
14 they advertise.

15 But they're running a special on a
16 13-month jumbo at 3 percent and that doesn't get
17 captured. And I think that's something that's
18 changed and that's much more prevalent than what was
19 envisioned in 2009.

20 MEMBER TURNER: And if somebody were to
21 come in the branch and say they were getting ready
22 to move, they were going to pay more than 25 basis

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1 points. So it's not really reflective of what the
2 market is.

3 I think you guys did a terrific job of
4 explaining the regime. I feel like I understand it
5 now. And I understand where the FDIC is coming
6 from.

7 If I was in your shoes though the last
8 thing I would ever want is a bank to fail as a result
9 of lack of liquidity that was otherwise viable
10 because the FDIC is going to lose money every time
11 on that bank when it fails.

12 So I would be trying to -- now, you don't
13 have the ability. The statute specifies that these
14 things will be prohibited. It's your job I guess
15 to define what substantially in excess of the market
16 is.

17 So you've got to identify what's the
18 margin over the market and then what's the market.
19 It seems to me the margin over the market should
20 probably vary based on what the market is.

21 The higher the market rate, the higher
22 the margin should be probably. And then the market

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1 because of what we talked about you've got,
2 whatever, 3,000 Citi Corp branches factoring into
3 that number and they're three basis points or
4 whatever they are on everything.

5 I don't know, that's a hard question.

6 MS. MILLER: Tell me about it. Mary Ann
7 mentioned what do you use as an indices. We call
8 it the peg. Where do you set the peg is an issue.

9 Interestingly if you just reduce --
10 currently anyway if you just reduce it to main
11 office, so Citi or B of A doesn't get 10,000 votes
12 or whatever you don't get that much of a lift just
13 because just overall rates are super, super low.

14 There's the 75 basis points. Could it
15 be something sliding?

16 There's two issues when you said as the
17 FDIC we wouldn't be somebody where a viable
18 institution failed because of this.

19 We were also in this period of time when
20 interest rates were artificially low where banks
21 were staying afloat and not having to make the hard
22 choices.

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1 There's a reason why there's rate
2 restrictions is because you're in trouble, you've
3 got to do something to fix this problem. So it also
4 served when we had very low interest rates to sort
5 of help those institutions stay afloat which
6 probably should have made those hard choices and
7 fired management and shrunk and done those things
8 and they didn't have to do that. So it's a
9 balancing act.

10 MEMBER DONNELLY: I think Jack talked
11 about credit unions. I'd really -- I'm not here to
12 bash credit unions today but it's -- you look at my
13 QwickRate portfolio it's all credit unions, 100
14 percent. So I'm basically funding them to outbid
15 me on the CD and buy it back.

16 (Simultaneous speaking)

17 MEMBER DONNELLY: -- they've under bid
18 me on.

19 But if you discount that in the picture
20 you're missing a huge piece of the big picture and
21 it's evolving so rapidly as we speak in the
22 Synchrony Bank and all those. Those things, the

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1 evolution is so quick I don't think we have 10 or
2 15 years to deal with it. I think it has to be dealt
3 with in a much compressed period of time because
4 that's getting worse instead of better.

5 I really think that needs to be somehow
6 added.

7 MEMBER HARTINGS: Joe mentioned the
8 differential as rates go up. But as rates are
9 moving there's -- when rates seek that level there's
10 not as many specials, not as much kind of cloak and
11 dagger out there.

12 And you've got to figure out somehow how
13 to consider that in this formula because I would
14 tell you right now your rate survey is not a very
15 good survey because you're not capturing. Stuff's
16 going like this and they're hiding it here, they're
17 hiding it there. We're all trying to figure out how
18 to do it.

19 Now, once we get up to that level we stay
20 there for six months, eight months, a year, it all
21 kind of levels out. But this is really, your rate
22 survey is probably not capturing today what the

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1 rate's really doing out there.

2 MEMBER HANRAHAN: Rae-Ann, I found the
3 history very helpful. Shame on me. I did not know
4 that the methodology changed in 2009 so that was
5 good information to have.

6 I'm glad that FDIC saw fit to make a
7 change in '09 when it stopped not working perfectly.
8 And it seems like FDIC is open to consider other
9 changes now as a result of the RFP that's going out.

10 This chart I think really tells the
11 story. And one of the reasons I do conclude there's
12 something wrong with it is if a bank that's paying
13 a rate less than half the cost of the rate at which
14 the U.S. Treasury borrows money how could that be
15 regarded as a high rate? Does that mean the U.S.
16 Treasury is overpaying by two times?

17 It just seems to me on its face to be not
18 working right.

19 MR. DAVIS: Any other questions?

20 MEMBER DONNELLY: Nobody else wants to
21 put their neck out there.

22 MS. MILLER: How do you follow that?

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1 MR. DAVIS: Thank you very much. That
2 concludes the panel for today so I'll turn it back
3 over to the chairman for closing remarks.

4 CHAIRMAN McWILLIAMS: Thank you, Chad.
5 Thank you, Rae-Ann and Vivek.

6 So you definitely listened to my
7 suggestion not to fall asleep this afternoon.
8 Thank you all. This was incredibly valuable and I
9 just want to take a minute to say goodbye to the old
10 friends and welcome the new ones to the committee.
11 And I'll turn it over to Marty for the closing
12 remarks.

13 BOARD DIRECTOR GRUENBERG: I don't have
14 much to add. Let me take the opportunity to thank
15 Mary Ann and John and Jack and Chris for their
16 service as well as to welcome our new members.

17 I'm really struck again with the quality
18 of the conversations we have and the value of the
19 input that you provide to us. It's really
20 thoughtful and nuanced and you don't always agree
21 with one another which makes it even more valuable
22 from my standpoint.

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1 I thought I'd like to commend the
2 chairman for having the round table, adding the
3 round table to the meeting this morning. I thought
4 that was as fine a seminar on community banking that
5 I've ever participated in. I learned a great deal.
6 And it adds a lot of value to the agency. So thank
7 you all.

8 CHAIRMAN MCWILLIAMS: Thank you.

9 (Whereupon, the above-entitled matter
10 went off the record at 3:16 p.m.)
11

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