

The Meeting of the Advisory Committee on Community Banking

of the

Federal Deposit Insurance Corporation

Held in the Board Room

Federal Deposit Insurance Corporation Building

Washington, D.C.

Open to Public Observation

November 8, 2012 – 8:33 A.M.

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

The members of the Committee present at the meeting were: Robert F. Baronner, Jr., President and Chief Executive Officer (“CEO”), Bank of Charles Town, Charles Town, West Virginia; R. Daniel Blanton, President and CEO, Southeastern Bank Financial Corporation and Georgia Bank & Trust Company of Augusta, Augusta, Georgia; Charles G. Brown, III, Chairman and CEO, Insignia Bank, Sarasota, Florida; James H. Gray, Chairman, Beach Business Bank, Manhattan Beach, California; Jack E. Hopkins, President and CEO, CorTrust Bank, National Association, Sioux Falls, South Dakota; Ann Marie Mehlum, President and CEO, Summit Bank, Eugene, Oregon; Joseph G. Pierce, President and CEO, Farmers State Bank, Lagrange, Indiana; Rebecca Romero Rainey, Chairman and CEO, Centinel Bank, Taos, New Mexico; Dorothy A. Savarese, President and CEO, Cape Cod Five Cents Savings Bank, Orleans, Massachusetts; Alan Thian, President and CEO, Royal Business Bank, Los Angeles, California; Ignacio Urrabazo, Jr., President, Commerce Bank, Laredo, Texas; and Matthew Williams, Chairman and President, Gothenburg State Bank & Trust Company, Gothenburg, Nebraska.

Deborah A. Cole, President and CEO, Citizens Savings Bank and Trust Company, Nashville, Tennessee; Carolyn “Betsy” Flynn, President and CEO, Community Financial Services Bank, Benton, Kentucky; and Walter E. Grady, President and CEO, Seaway Bank and Trust Company, Chicago, Illinois were absent from the meeting.

Members of the FDIC Board of Directors present at the meeting were: Martin J. Gruenberg, Acting Chairman; Thomas M. Hoenig; and Jeremiah O. Norton.

Corporation staff who attended the meeting included: Willa M. Allen, Kevin T. Angell, Steven O. App, Gary Bowser, Richard A. Brown, Kymberly K. Copa, Carolyn Curran, Christine M. Davis, Michael J. Dean, Patricia B. Devoti, Doreen R. Eberley, Bret D. Edwards, Diane Ellis,

Kristie K. Elmquist, Robert E. Feldman, George French, Shannon N. Greco, Marianne Hatheway, Shamara L. Humbles, Stan R. Ivie, Lance D. Jameson, Craig R. Jarvill, Sally J. Kearney, Ellen W. Lazar, Alan W. Levy, M. Anthony Lowe, Christopher Lucas, Jonathan N. Miller, Robert W. Mooney, Charles Morris, Mark S. Moylan, Arthur J. Murton, Christopher J. Newbury, Thomas E. Nixon, Bimal V. Patel, Mark E. Pearce, Sylvia H. Plunkett, Stephen A. Quick, Claude A. Rollin, Lorraine D. Rushing, Barbara A. Ryan, Maureen Sweeney, Sandra L. Thompson, John F. Vogel, James C. Watkins, John D. Weier, Mindy West, and Katherine G. Wyatt.

William A. Rowe, III, Deputy to the Chief of Staff and Liaison to the FDIC, Office of the Comptroller of the Currency, was also present at the meeting.

Acting Chairman Gruenberg welcomed the members to the tenth meeting of the Committee and remarked on the great value of the information and advice that the Committee provided to the FDIC. He noted this would be certain Committee members' last meeting and thanked them for their contributions and willingness to serve. Acting Chairman Gruenberg provided an overview of the day's discussions, including panel discussions of various aspects of the FDIC initiative on community banking. He observed that the initiative's roundtable discussions held with bankers and other stakeholders in each FDIC region had been very helpful and that the FDIC had already begun incorporating recommendations from the meetings into its research and review of its examination and rulemaking processes. Acting Chairman Gruenberg introduced Chief of Staff Barbara Ryan, who moderated the day's meeting.

Ms. Ryan introduced John Weier, Special Advisor to the Acting Chairman, and Christopher Newbury, Associate Director, Division of Insurance and Research ("DIR"), who led the "Summary of Issues Raised at the Banker Roundtables" panel. Mr. Weier reviewed how the banker roundtables were structured, noting that the meetings were held in the six cities with FDIC Regional Offices. Each meeting was attended by 45 to 70 bankers, state commissioners, and trade representatives as well as FDIC Acting Chairman Gruenberg, either Director Thomas Hoenig or Director Jeremiah Norton, the directors of the Division of Risk Management Supervision ("RMS") and the Division of Depositor and Consumer Protection ("DCP"), as well as the regional director where the meeting was held. Mr. Weier said each meeting was divided into two sessions totaling about three to four hours; the first session was devoted to financial opportunities and challenges faced by community banks and the second session focused on community banks' interaction with the regulatory and supervisory processes. The purpose of the meetings, he observed, was for the FDIC and community bankers to have direct, unfiltered communication with each other on important subjects and to allow bankers to hear other bankers' views on the issues.

Mr. Newbury provided an overview of the subjects discussed in the roundtable meetings, starting with community banks' financial and operational challenges and opportunities. Generally, he said, the community banking model continued to be viable and would survive and prosper into the future but that bankers also expressed concerns on a variety of specific topics. The specific concerns included, he said, the lower earnings potential for community banks, the decreased stature of the banking profession in the wake of the financial crisis, and fatigue from coping with continued economic stress and increasing regulatory requirements. Mr. Newbury

also reported that bankers expressed concern about the rapid pace of technological change, both in the core technologies used to run a bank and in emerging technologies to deliver financial products to customers. He also noted that bankers perceived unfair competition from large banks, credit unions, and farm credit banks. Finally, he noted bankers expressed concern about attracting new investors and the continuing attractiveness of bank stock in light of the issues described earlier.

Mr. Newbury described the feedback the FDIC received, including the status of the loan market, staffing issues, technology matters, interest rate risk (“IRR”), and the possible extension of the Transaction Account Guarantee (“TAG”) program. Regarding the loan market, he said bankers reported that there was an insufficient volume of high quality loans available in many markets; that there was extreme competition for loans, often from larger competitors; and that there was pressure on both loan rates and terms. Concerning staffing, Mr. Newbury reported many bankers found it easier to attract new employees, particularly college graduates, but harder to retain well-trained staff, and that some specialized areas were very hard to staff, including compliance, information technology, and trust services. About technological issues, he said, bankers reported increased customer demand for services such as mobile banking and remote deposit capture and banker concerns about the safety and security of the technologies. Mr. Newbury reported that some bankers were hiring technically savvy staff to respond to these concerns while others were relying on their core processing firms for initiatives. He reported that bankers often expressed a desire for more information from regulators regarding how to establish adequate controls for new technologies. Regarding IRR, he reported the current low interest rate environment was adversely affecting current earnings and net interest margins, which were leading to potential IRR problems as bankers lengthened loan and investment maturities. Mr. Newbury said bankers were interested in the FDIC providing an updated IRR advisory. Concerning the TAG program, he reported that a majority of bankers favored extending it, a minority favored allowing it to expire, and some suggested extending the program but including an opt-in/opt-out clause or imposing a fee for insurance coverage over normal limits.

Mr. Weier provided an overview of the roundtable discussions concerning regulatory interactions; he said relatively common themes emerged despite the wide diversity of bankers and locales. The first general roundtable theme he described concerned general examination issues. The comments were generally favorable, he said, but bankers suggested four areas for the FDIC’s attention: 1) improving the focus of the pre-examination process and ensuring the FDIC uses all the information requested; 2) providing a more uniform way for the FDIC to share information electronically with banks, such as through “FDICConnect”; 3) using experienced examination teams who are familiar with banks’ local markets to perform examinations; and 4) working to ensure that examination reports are timely and that there is consistency among communications during an examination, the close-out meetings, and the examination report itself.

Mr. Weier described roundtable feedback concerning regulations. He said there was a perception of an excessive buildup of regulations and the need for more scrutiny on existing ones. Mr. Weier indicated that bankers were concerned about new regulations and requested information about what was in the pipeline, when new regulations would become effective, and

how they would affect community banks. He said bankers expressed interest in receiving flexibility in compliance phase-in times. Mr. Weier said roundtable feedback indicated FDIC communications are generally good now, but were not at the beginning of the crisis, and deserve continued focus. He said that bankers expressed interest in more communication outside the examination process; for example, concerning emerging risks or to assess bank plans with FDIC field or regional offices. Mr. Weier said banker interest in FDIC technical assistance was tied to the previous topics he discussed because bankers needed to continue to meet their regulatory obligations, even as there were increasing demands on their time. The FDIC's Director's Colleges were viewed favorably, he said, and there were suggestions the FDIC produce training for bank staff in areas such as consumer compliance, troubled debt restructuring, capital regulations and information technology.

Committee members generally expressed agreement with the summaries and added various points of emphasis. Members Blanton and Pierce spoke about loan competition's effect on rates and terms and the potential risks associated with them. Member Gray noted the improvement in the examination process from an antagonistic relationship to a positive one and said he valued learning from examiners what they were seeing in other area banks. Member Savarese observed that the pace of change was increasing and it was important for community banks and regulators to work collaboratively and provide mutual feedback at a quicker pace. She complimented the FDIC, for example, for implementing improvements suggested in early roundtables and elsewhere; she noted that quarterly bulletins would not have been fast enough to respond to the challenges facing community banks.

Member Urrabazo expressed concern about the survival of community banking due to the variety of challenges it faces. He remarked that community banks cannot compete against very large banks on pricing or technology but do successfully compete through their ability to exercise discretion in small business lending; he added that overly restrictive regulations would be destructive if they impeded this decision-making flexibility. Member Savarese observed that another effect of excessively restrictive regulatory constraints on community bank lending would be to attract unregulated financial institutions to enter markets (for example, the payments system). If that were to happen, she said, it could inadvertently expose consumers to greater risk. Member Blanton agreed and said that a customer's payment of a non-sufficient funds ("NSF") fee to a bank may be the cheapest access to money that a customer needs and that regulatory restrictions on NSF fees could push such customers to unregulated finance businesses where consumers have fewer protections.

In response to a question from Member Mehlum about the FDIC's priorities after receiving the roundtable feedback, Mr. Weier said the FDIC had not wanted to wait to implement some changes and is continuing development of other changes that would be discussed later in the day and in the coming months. He said the FDIC favors community banks being able to prosper by reacting to the marketplace in a safe and prudent manner. He added that the regulatory tension was in determining what is safe and sound and that the FDIC welcomed feedback on establishing the proper balance. Members Brown and Williams expressed appreciation of the FDIC's initiative and emphasized the importance of taking action. Member Williams noted there was risk in non-action as well as action and suggested the FDIC take actions that are supportive of community banking without regard to whether it was viewed as the

“right” political time. Member Brown commented that all the areas discussed related back to capital and return on investment; he said community bankers had to focus on overcoming pressure on their earnings and providing a return to their shareholders. Member Gray noted that there was considerable concern about regulations still being drafted and said it was important for regulators to make sure bankers understood what would be expected of them.

Ms. Ryan then introduced Sylvia Plunkett, Senior Deputy Director, DCP; James Watkins, Deputy Director, RMS; and Kristie Elmquist, Regional Director, Dallas, who led the “Update on Supervisory Process Initiatives” panel. Ms. Plunkett said their discussion would preview some steps DCP and RMS had taken to improve the supervisory process in five areas based on earlier examiner feedback, Committee input, and roundtable recommendations. The first of the five areas, she said, was pre-examination planning: a process starting with the first FDIC preparations for an examination, including the first off-site contact with a bank and continuing through the examiners’ entrance meeting with the bank. Ms. Plunkett said the FDIC had highlighted to examiners the need to appropriately scope an examination to *only* the risks the bank presented, had developed electronic tools to assist examiners in scoping (which would later be discussed by Mr. Watkins) and is providing guidance on effective scoping. She then discussed the second area, the post-examination process, which includes the time required to complete a report and communicate with bankers on actions needed. Ms. Plunkett noted that the FDIC was reviewing ways to finalize reports sooner in DCP by improving the consultation process for complex matters. In addition, the FDIC would make an effort to ensure that FDIC communications with banks were consistent and ongoing during examinations, in examination reports, and after examinations. She said the FDIC recently issued a Financial Institution Letter (“FIL”) categorizing compliance examination violations so that bankers could better understand the FDIC’s areas of greatest concern and where banks should focus their attention first. Regarding the third area of review, the use of technology to assist in efficient examinations and improving communications with banks, Ms. Plunkett said the FDIC had developed several tools that Mr. Watkins would discuss later.

The fourth broad area of review Ms. Plunkett discussed was communications. She said that the FDIC is providing examiner guidance and has developed an information package for banks which explains the examination process and describes various sources available to bankers in communicating with the FDIC about examination issues, including the Ombudsman and appeals processes. The fifth area she discussed was outreach and technical assistance, including FDIC-sponsored Director’s Colleges conducted at the regional level, participation in trade events, and industry-wide banker calls on topics such as proposed mortgage rules and capital rulemaking. To improve consistency, Ms. Plunkett said DCP was developing a brochure on the types and subjects of technical assistance the FDIC can provide and that the FDIC website’s Director’s Resource Center had been upgraded with new material.

Mr. Watkins then provided the Committee with an overview of the FDIC’s pre-examination planning process and its efforts to enhance and streamline the process, including a new pre-examination planning tool for examiners. He observed that the pre-examination planning process is one of the best tools for risk assessment and supervisory oversight because it helps focus on a bank’s critical risk areas and keeps examiners’ onsite activities well-coordinated and properly scaled to risks. Mr. Watkins added that good planning, communication, and

execution contribute to appropriate risk assessments and to more timely examination reports that provide helpful recommendations to bankers. He said that the FDIC's internal review had pointed toward the development of web-based tools to streamline the pre-examination planning process which would direct the focus to relevant and current issues at each bank. Mr. Watkins also said the FDIC was taking steps to ensure examiners had adequate preparation time to digest the information the FDIC requested before going onsite.

Ms. Elmquist provided an overview of the "ePREP" pre-examination planning tool for RMS examiners, one of the tools referred to by Mr. Watkins, which was currently in a testing stage in all regions. She noted the new tool responded to banker concerns about pre-examination document requests and fit within the FDIC's existing expectation that examiners should familiarize themselves with a bank before going onsite by reviewing previous examination reports, Call Reports, and correspondence with the bank, as well as contacting the banks' management to learn about changes at the bank since the last examination. Referring to a handout included in the meeting package, Ms. Elmquist discussed several slides which showed various filters that help examiners scope the examination and tailor their information requests to the bank's business while automatically eliminating duplicative requests. In addition to giving banks adequate time to respond to the information requests, Ms. Elmquist and Mr. Watkins emphasized the FDIC's commitment to provide examiners sufficient time to review and assess the bank's information before going onsite. Ms. Plunkett reported that DCP's version of the pre-examination planning tool would begin testing in December 2012; the tool would ask banks about the products and services they offer so that examiners would not request unnecessary information.

Committee members generally expressed support for the new pre-examination planning program. In response to a question from Member Williams about the timing expectations, Ms. Elmquist said the FDIC would try to make its pre-examination information requests between 60 and 45 days before the onsite examination began and generally allow examiners two weeks to review the responses (with a minimum of one week for review). Member Blanton said his bank recognized the value of supplying information early to contribute to smoother examinations. Member Brown later warned that pre-examination information can be requested too early and that such information can become stale if changes in products and policies occur before examiners arrive onsite.

Member Savarese emphasized the importance of examiners having adequate time to assess a bank's information. She said a bank had to work hard to provide requested information in 30 days and it was discouraging to learn that examiners had not reviewed it meaningfully. Mr. Watkins agreed that it was in both the bank's and the FDIC's interest for examiners to arrive onsite prepared and focused; he said the FDIC would continue to emphasize the importance of preparation as the new program is rolled out, especially to supervisors who schedule staff for examinations. Member Brown observed there is often limited space in a bank to house examiners and suggested the FDIC consider giving examiners additional time to review information before arriving onsite if that would reduce the number of examiners (or days) needed onsite.

Member Hopkins said many banks had moved to document imaging instead of paper copies and inquired whether the FDIC had considered accepting and reviewing document images before coming onsite. Mr. Watkins said the FDIC was exploring moving toward greater use of electronic images, but noted there would be a continuing need to test and confirm original documents. Mr. Watkins agreed with Member Williams that information security would be an important issue in any such transition. Member Savarese noted that, with banks' adoption of new technologies, bank files may contain few paper originals for examiners to review. She also observed that these continuing technological changes required ongoing collaboration between banks and the FDIC. In response to a question from Member Baronner, Mr. Watkins said the FDIC expected the official implementation date of the new program to be in the first quarter of 2013, after the pilot results are evaluated and any necessary changes are made.

Member Williams inquired about FDIC time targets for the completion of compliance examination reports and the achievement of those targets. Ms. Plunkett responded that DCP's target for compliance-only examinations is 90 days (from the start of the onsite phase of an examination to the sending of the report) for 90 percent of examinations. For a joint compliance and Community Reinvestment Act examination, she said DCP's target is 120 to 150 days for 90 percent of examinations. She said DCP consistently met those goals. Ms. Plunkett observed that about 10 percent of examinations raised unique issues requiring legal consultation to ensure the right outcome was achieved and that DCP and Legal were reviewing their processes to make them timelier. In response to Member Savarese's inquiry asking if a full quarter was an appropriate time target for the written report, Mr. Watkins said the goal was to get timely information to banks so they could make use of it but noted that unique issues or products can require accounting or legal specialists and additional attention to ensure the answer is correct.

Member Blanton expressed his preference for examiners who were familiar with his bank and local area conditions; he said examinations by non-local examiners were less efficient. Member Urrabazo agreed and reported his bank's most recent safety and soundness examination had gone smoothly and quickly with a relatively young head examiner and a group of experienced examiners who were familiar with his bank; he contrasted the recent examination with one about four years earlier in which he felt the examiner was undertrained and the bank received conflicting advice. Member Pierce had earlier noted his bank received its last safety and soundness written examination report within five days of the exit interview. Member Mehlum inquired if it was the FDIC's view that examiners who were knowledgeable about a bank and its local area conditions produced better examinations. Mr. Watkins said the FDIC has always been structured to try to have local staff that is familiar with the market areas they examine. He noted the FDIC occasionally had to redirect staff resources into areas where greater attention was needed (as had recently occurred in the Atlanta region) resulting in greater use of non-local examiners. Regarding the Atlanta region, Mr. Watkins indicated a better equilibrium of work and staff had been achieved and he expected fewer examinations would need to be conducted by staff from outside the region.

Mr. Watkins gave the Committee an overview of the "Director's Resource Center" on the FDIC website, where bank officials and industry analysts can access a variety of banking regulatory resources. The resources include the "Director's Colleges" program, which lists learning opportunities for bank directors and bank officials provided in live meetings by FDIC

regional offices. Mr. Watkins also identified a location on the FDIC website where bankers could access reference materials such as the “Pocket Guide for Directors;” FILs on risk management and consumer protection topics; and FDIC-created presentations on various laws, regulations, and bank operation topics. Jonathan Miller, Deputy Director, Policy and Research, DCP, then gave the Committee an overview of the FDIC Regulatory Calendar, which was created in response to banker and public requests for a simple place to find regulations in development that may affect community banks. Referring to a handout and his simultaneous live demonstration, he showed members how to find proposed regulations, identify when public comments on a regulation are due, and other functions. Mr. Miller also demonstrated how bankers and the public may access information about various FDIC community banking initiatives.

Committee members voiced approval of the initiatives. Member Gray said the initiatives achieved Acting Chairman Gruenberg’s goal of translating banker feedback from the roundtable discussions into action items and that bankers would be pleased the FDIC had responded to their concerns. Member Savarese said the resources for directors were responsive to her bank’s needs and the calendar responded to banker feedback. In response to Member Saverese’s inquiry, Mr. Miller said that the FDIC generally could not release specific information about rules in development before the FDIC Board voted on notices of proposed rulemaking, but noted the Consumer Financial Protection Bureau (“CFPB”) rulemakings go through extensive processes in which most community banks can participate.

Member Pierce encouraged the FDIC to continue making director training opportunities available on the internet because many bank directors have time constraints limiting their ability to attend live events. Mr. Watkins said the FDIC was exploring the use of video presentations on various topics, such as the effect of Basel III on capital ratios. In response to Acting Chairman Gruenberg and Mr. Watkins’ inquiry as to whether bank directors would use such videos, Member Pierce indicated that they would and suggested the FDIC make segments from 60 to 90 minutes long. Member Urrabazo said many directors serve on specialized committees and would be interested in more detailed training focused on their particular needs. Member Baronner suggested the FDIC follow the lead of online college courses that can be taken over a year; he indicated such an approach would save banks money and help more directors receive training. Member Savarese remarked that many banks provide their staff with compliance training online and are beginning to introduce online training at the director level. She added it was important for banks and regulators to continue to learn from each other’s progress in training approaches.

The Committee and staff also discussed the level of detail that could or should be offered in FDIC-produced training aimed at bank directors as well as bank officers and staff. Member Brown noted that directors of banks of different sizes and business models needed different levels of specificity on certain subjects. Member Savarese later agreed with this point and emphasized the importance of properly scaling materials to the directors’ needs. Member Brown also indicated there are continuing questions about the level of detail of the information banks should present to directors in board meetings (and the resulting specificity of board votes). He said, for example, some vendors were advising that directors should review and approve only general summaries of loan reports in board meetings (rather than lists of actual loans) in order to decrease liability exposure. Member Brown inquired if the FDIC had seen best practices on the

issue. Mr. Watkins said most Director's College materials emphasized concepts and principles rather than granular details such as how detailed a board package should be. For example, he said FDIC materials for directors on the subject of IRR might explain what a bank director should know about IRR, what normal and extreme IRR positions would be, and what banks might do to mitigate IRR.

Mr. Watkins said there appeared to be an appetite for bank officer training on subjects such as Bank Secrecy Act ("BSA") compliance, which would likely be more specific than bank director training. Member Urrabazo reported that he gave detailed presentations to bank directors on BSA and compliance matters so they could appreciate the law's complexity and the level of detail required of bank officers and staff. Member Rainey said she sensed there may be a significant change in the structure and detail of FDIC director training and said these new approaches had tremendous value. She observed that banks may continue to perceive director training as a "one-time" event relating to corporate governance and broader topics and encouraged the FDIC to make any changes in its approach clear in its marketing.

Members Savarese and Brown observed that banks may provide directors with lengthy packages of materials relating to their and the bank's duties but expressed concern that the sheer amount of material interfered with directors being able to recognize and appreciate the most important elements. Member Thian said directors of de novo banks may not fully understand their responsibilities, especially if they were drawn to become a director because of prestige associated with the position. He suggested training focused on de novo bank directors would help them understand their responsibilities and the risks they face.

The Committee stood in recess at 10:19 a.m. and reconvened at 10:38 a.m. that same day.

Ms. Ryan then introduced Arthur Murton, Director, DIR; and Richard Brown, Associate Director, DIR, and Chief Economist; who led a discussion titled, "Update on FDIC's Community Bank Research." Mr. Murton provided an overview of an FDIC study to be published in December 2012. He noted the data-driven study was based on a variety of available materials, including Call Report and Thrift Financial Report information dating back to 1984, which FDIC staff studied to analyze trends in community banking in the last three decades. Mr. Murton observed that the FDIC's community banking research also was foundational in that it publishes datasets for subsequent research by bankers and other analysts, and that the FDIC was building tools to make the information available and easily accessible. He then outlined the content of the study's six chapters, beginning with the definition of a community bank. Mr. Murton noted that many researchers rely solely on a size threshold, typically assumed to be \$1 billion dollars in assets, to define a community bank. In contrast, the FDIC research definition developed for this study considered additional factors, including balance sheet data, loans and deposits, and geographic footprint. As a result, he said, the FDIC included as community banks about 300 institutions with assets over \$1 billion and excluded about 100 specialty banks under \$1 billion.

The study's second chapter, Mr. Murton said, explored structural changes in the banking industry over time. He noted there had been a substantial decline in the number of chartered institutions since 1984 and said the study would explore the factors contributing to the changes, including intra-company consolidations, acquisitions, failures, and new charters. The study

would also explore the role played by changes in Federal and State laws concerning interstate and intrastate banking. Mr. Murton observed that the largest decline in the number of charters occurred among banks with assets below \$100 million; there was more stability in the number of charters among banks between \$100 million and \$10 billion in assets. He also noted there had been significant growth in the amount of assets held by the largest banks (those over \$100 billion of assets) and said the study would describe these changes.

Mr. Murton said the study's third chapter would consider the geography of community banking, with a focus on differences in rural and metropolitan areas. He noted that, while there are many community banks in metropolitan areas, community banks tend to be highly represented in rural areas and may be the only source of banking services in many places. The next chapter, Mr. Murton said, would describe the comparative financial performance of community banks and non-community banks, including an exploration of why community banks experienced higher pre-tax return on assets than non-community banks in the decade before the recent financial crisis. The study's fifth chapter would compare community banks focused on different lending specialties (such as residential, consumer, and commercial real estate) and try to explain differences in performance across these specialty groups. Mr. Murton said that, in addition to the focus on bank analysis, the study would also refer to econometric work the FDIC staff had done on questions such as performance, cost structure, and economies of scale (he noted the econometric work would also be published in separate papers). Mr. Murton said work was ongoing in the areas of community bank capital formation and non-bank competitors to community banks.

Member Brown inquired whether the FDIC had been able to use the criteria of local ownership and local decision-making in defining a community bank. Mr. Brown noted there was limited specific data available about those criteria and provided further detail about how the FDIC defined community banks. He said the FDIC first excluded certain specialty banks (such as banks with no deposits, no assets, or a high degree of foreign assets). Afterward, he said, it applied certain lending and deposit gathering criteria (such as loans making up at least one third of assets and core deposits constituting at least half of assets) and then limited the geographic scope by excluding banks who operated in many states or metropolitan areas. Mr. Brown described other adjustments the FDIC made and concluded that, although no community bank definition was perfect, he thought the FDIC's definition was both a good approximation and a good foundation for future work on the subject. Mr. Murton noted that the FDIC's definition identified about 6,800 community banks out of 7,400 charters in 2011. Member Savarese asked whether the FDIC study's findings would be segmented into shorter time periods than the entire 28 years reviewed, noting that information about the most recent period was of critical interest. Mr. Murton said much of the study's analysis was broken into five-year segments; he agreed the most recent period was important but noted it was difficult to determine which drivers in the most recent period are cyclical and which represent fundamental, non-cyclical changes.

Member Hopkins inquired if the FDIC's study would draw any conclusions about the likely number of community banks in the future. Mr. Murton said the study would analyze what had occurred to banks that existed in 1984: whether they still existed, had failed, had been acquired because they were troubled, or had been acquired for good reasons. He noted there were about 5,000 banks from 1984 that remained in business today and that there would likely

continue to be business for community banks that “stick to their knitting.” In response to a question from Member Urrabazo, Mr. Murton said the FDIC study would document bank acquisitions and failures and other data, as well as dissecting various performance indicators and the apparent performance drivers, but would not evaluate the effects of new rules such as Basel III, which was not yet final.

Member Pierce asked whether there appeared to be an optimal size for a community bank. Mr. Murton said the FDIC found that many banks with assets below \$1 billion succeeded throughout the period studied, and that a more sophisticated econometric analysis, including cost structure and economies of scale, appeared to indicate there is a range of sizes in which a community bank could be successful, depending on its specialty type. Member Blanton observed that a bank’s ownership type and risk appetite were important factors in addition to asset size. Mr. Brown agreed; he noted there were many longstanding banks which were closely held, pursued a conservative course, and had a strong and consistent earnings’ profile over time. Mr. Brown also observed the greatest decline in number of charters had occurred in the smallest institutions (of less than \$50 million) and there was less consolidation among larger institutions, including those of about \$100 million.

In response to a question from Member Savarese, Mr. Murton characterized the FDIC’s study as more foundational and retrospective, with less emphasis on making predictions about future developments. He did note, however, that by identifying important drivers over the last 25 years, the study may suggest trends that may continue into the future. Mr. Brown said that, while the FDIC had possessed the data for a long time, it had not been reviewed in the same depth as the current study and he felt the deeper look would help illuminate future policy discussions. Member Williams agreed a data-driven study was important and said bankers and regulators are good at analyzing data, but indicated the primary challenge would be to convert the information into action steps involving banks, regulators, and legislators. He also observed that larger social issues were involved, noting that, in some geographic areas, if a community bank is not making loans, then no loans are being made. Member Williams added he felt regulators could be more creative in regulating community banks compared to other banks without compromising a safe banking system.

Member Thian inquired about the FDIC’s views of the projected competition for community banks, including credit unions and very large banks. Mr. Brown discussed the gravitation of non-community banks to metropolitan areas, creating strong competition for community banks in those areas. Member Savarese observed that non-bank financial service providers had an increasingly large presence in the U.S. payment system and inquired to what extent the FDIC had considered the broader payment system in its studies. Mr. Murton agreed the issue was a valid one but indicated the data available did not speak well to the question. Members Thian, Urrabazo, and Blanton provided examples of competitors—including very large banks and payday lenders—who offered lending terms that community banks could not match, or who were able to make larger profits on the same amounts of lending. In response to a question from Member Brown, Mr. Brown indicated the FDIC’s studies were unlikely to answer whether there is an optimal number of banks in a community or in the U.S., but indicated he thought there would continue to be a place for community banks.

Ms. Ryan then introduced George French, Deputy Director, RMS; and Jonathan Miller, Deputy Director, DCP; who moderated the “Discussion of Current Policy Issues” panel. Mr. French provided the Committee with an overview of two interagency notices of proposed rulemaking regarding capital requirements the FDIC had approved in June and about which the FDIC (and other banking agencies) had received substantial public comments. He first described the Basel III implementation proposed rule which would generally revise the definition of regulatory capital and the minimum levels of capital banks would be required to maintain. Mr. French noted that the proposed rule would create a “common equity Tier 1 capital ratio” as a new capital requirement and explained how it would impact the existing definition of capital, change the treatment of “accumulated other comprehensive income” (“AOCI”) in regulatory capital, and phase out the inclusion of trust preferred securities from Tier 1 capital. He described the levels of minimum capital requirements that would exist under the proposed rule and compared them to the current levels. Finally, Mr. French described the Basel III proposed rule’s “capital conservation buffer” requirement, a sliding restriction on dividends and bonuses for banks that maintained less than 2.5 percentage points more than their regulatory minimum capital. Mr. French then gave the Committee an overview of the “Standardized Approach for Risk-Weighted Assets” proposed rule which seeks to improve the measurement of risk-weighted assets.

Mr. French said that, in light of the recent economic crisis, the FDIC was focused on strengthening the capital adequacy of the banking system but also wanted to ensure it appropriately addressed bankers’ concerns about potential unintended consequences. He said the FDIC made significant outreach efforts to ensure community banks were aware of the proposed rules and understood their impact. He indicated that the outreach resulted in a substantial number of high-quality comments received (about 1,000 as of the meeting) which the FDIC was seriously reviewing. Mr. French noted the most frequent comments about the Basel III proposed rule concerned the AOCI issue and the phase out of the trust preferred securities and the most common comment about the standardized approach rulemaking concerned changes in residential mortgage risk weights.

Mr. Miller noted mortgage market problems were a fundamental cause of the recent financial crisis and that the Dodd-Frank Wall Street Reform and Consumer Protection Act (the “Dodd-Frank Act”) required rulemaking on a variety of mortgage-related subjects. He said the FDIC was a joint rule writer for two rules (Appraisal and Qualified Residential Mortgage) but that the majority of the rules were the responsibility of the CFPB and were due to be finalized by mid-January 2013 or the statute itself would become effective. Mr. Miller noted it was important for bankers to be aware of what would be expected of them in the new rules and described the FDIC’s outreach efforts to alert them and others. He said the outreach efforts included two national banker calls in which new rules were discussed so participants could consider making public comments and prepare for the rules’ impacts; each of the calls involved close to 10,000 participants with a large representation of community bank compliance officers and senior management.

Mr. Miller said the Dodd-Frank Act obligates the CFPB to consult with other regulatory agencies in drafting its rules and provided an overview of the CFPB’s process. He noted that the CFPB gathers other regulators early in the process to discuss the issues they are concerned with

and the possible regulatory responses they are considering; the CFPB also shares data it has collected and the results of panel discussions it has had with small businesses. In addition to the exchange of information and opinion in the multi-agency meetings, Mr. Miller said the CFPB and FDIC continue to share information on an ongoing basis with a focus on the impact of rules on community banks as well as consumers; his impression was that the CFPB is open to hearing community bank concerns and that there is a healthy information exchange.

Mr. Miller provided additional detail about the CFPB's qualified mortgage rulemaking, relying on public information since the details of agency consultations are not public. He observed that the Dodd-Frank Act requires mortgages to be underwritten in a manner that ensures the borrower has the ability to repay the mortgage per its terms and discussed the criteria for a mortgage to be considered a "qualified mortgage," or one presumed to meet the ability to repay standard. Mr. Miller said the CFPB actively consulted with the other prudential regulators about the rule and the FDIC provided its perspective on the issues raised. He then discussed an issue that had been discussed in the press about CFPB options concerning qualified mortgages. Specifically, whether a mortgage that met the criteria to be a qualified mortgage would give the lender a "safe harbor" (in which a borrower could not later claim he or she did not actually have the ability to repay the loan), or whether a qualified mortgage would give the lender only the rebuttable presumption that the borrower had an ability to repay. Mr. Miller said the CFPB might make a distinction between the treatment of prime and subprime qualified mortgages. Mr. Miller said the CFPB had also consulted with the FDIC about defining the term "rural" as it relates to allowing certain balloon loans to be considered qualified mortgages; he said the Federal Reserve Board had formerly established a narrow definition of rural in this context. Finally, Mr. Miller said the FDIC was analyzing the interaction of various rules—including the qualified mortgage rule, the mortgage loan originator compensation rule, the escrow rule, and the appraisal rule—to determine how they would operate together, and was consulting with the CFPB about its analyses.

Member Hopkins said mortgage lending documentation was too complicated, confusing, and sometimes unnecessary; although he applauded the CFPB's effort to make it better for consumers, he said the proposed changes were peripheral and more fundamental changes were needed. He observed that his bank compared similar mortgages from 1979 and 2011; the former one required eight signatures and the recent one required 196. He noted many signature requirements related to features (such as prepayment features and adjustable rate option ARMS) that required a statistician to calculate the future payment. Member Mehlum said her bank no longer does mortgage lending because it concluded it could not provide enough support to ensure the lending was done properly. She expressed concern the increased complexity would result in there being only a handful of mortgage lenders in the country which would not be helpful to consumers. Member Brown agreed the number of mortgage lenders would decrease. He expressed the opinion the qualified mortgage rule would encourage litigation and make it harder for banks to manage their risks; he thought a more regulatory approach (one identifying how a well-underwritten and documented mortgage would look) would work better. Member Savarese observed that the cumulative and interactive effect of the three rules Mr. French and Mr. Miller discussed would be quite significant on smaller institutions and expressed the opinion that the regulators did not have sufficient loan level data to fully understand the proposed rules' impacts. She suggested that regulators superimpose the proposed rules on current banking activities at

samples of banks of different charters, sizes and locations to determine what the rules' effects would be before making the rules final.

Member Blanton recommended the CFPB adopt a realistic definition of "rural" in its mortgage lending rules; he indicated that a highly technical definition would dry up lending. Agreeing with an earlier comment by Member Hopkins, he recommended that mortgage products be kept simple and easy for a consumer to understand, while avoiding highly complex products that had no good reason for existing. Member Urrabazo said Congress and regulators had responded to the misconduct of a small percentage of "outlier" lenders by imposing burdensome and unnecessary regulations. He indicated regulators already had sufficient authority to identify the outliers and stop their misconduct, which regulators had not done. Member Savarese indicated the proposed one-size-fits-all mortgage lending regulations would have the effect of further diminishing community banks' already small percentage of mortgage lending and inhibit consumers' access to credit, particularly in rural areas. Member Rainey agreed, noting her bank was already the only lender available to certain borrowers and types of loans in her area; she indicated that regulations needed to allow for such unique lending needs or that type of lending would dry up. Member Williams said his bank was essentially the only mortgage lender in his rural market and, if it did not make mortgage loans, none would be made. He noted that mortgage lending was less profitable than agricultural lending available to his bank, in part because of regulatory compliance costs. He encouraged regulators not to increase the regulatory burden, which could have the effect of closing off mortgage lending in his community.

Member Williams said he supported banks maintaining strong capital, but warned if capital rules could reasonably be described as "daunting and complex" they would present problems for "plain vanilla" banks such as his. He indicated that, although his bank held a relatively low-risk bond portfolio, the AOCI rule's mark-to-market requirements could quickly have a negative impact on his bank's capital position if there was a relatively small change in market interest rates, a reasonably foreseeable occurrence. Member Williams said a similar small move in markets could significantly lower a community bank's legal lending limit, which could negatively affect borrowers and also harm the bank's ability to compete against other lenders, such as Farm Credit, which has no legal lending limit. He said these specific examples were part of the larger issue of how regulators could "change the slope" in the reduction of the number of community banks; if regulators were proactive, they could help stabilize the number of community banks by recognizing that some requirements would not work. Mr. French said the feedback was helpful; he explained the intended purpose of the AOCI requirement but said the FDIC and other agencies would consider the public comments seriously.

Member Brown said capital planning was important to his bank, which projects its capital standing several years into the future and tests different strategies within those projections. He said the proposed capital rule, which would require a bank to hold capital against increasingly precise classifications of loans, could not have been based on actual data since banks do not provide it to regulators in Call Reports. Member Brown indicated that loan officers and the Allowance for Loan and Lease Losses ("ALLL") were used to protect against various risks that could be estimated, while capital was used to protect against risks that were less predictable; in his opinion, the proposed capital rule blurred those distinctions. Member Blanton indicated his

bank calculated its ALLL based on each category of loan and also risk weighed each category but said the proposed Basel III rule gave no credit for the ALLL's precision. Member Savarese said the cumulative impact of the proposed rules would harm the ability of community banks to engage in low and moderate income lending, which involves high loan-to-value loans. Mr. French explained that some of the rules' requirements were based on research which established loan-to-value as a relevant criterion for banks' loan default and loss experience. With regard to underwriting characteristics, he said the regulators tried their best to sort through the data created by the financial crisis. On the other hand, Mr. French emphasized banks' comments were an integral part of the rulemaking process and the regulators would carefully consider any loan level data banks could offer, as well as banks' analyses of how the rules interacted with each other and would affect bank lending.

Member Brown suggested any capital requirements be subjected to a "viability" test of whether they would allow a sufficient return on equity that would be acceptable to investors, because without them there would not be banks or lending. Member Blanton later agreed with this point. Member Mehlum expressed the opinion that the Basel III standards were created to respond to issues that community banks did not face and that something more appropriate could be tailored to respond to banks' different balance sheets and risk portfolios. Mr. French responded that the starting point was to develop a capital regulation for banks, whether large or small, and then, through the comment process, try to minimize unintended consequences and undue compliance costs. Member Hopkins observed that even exceptionally high capital levels could not protect a bank where bad decisions were made; he said businesses and banks necessarily fail in times of economic stress and it was important not to crucify the rest of the banking industry because of those failures. Member Brown agreed a certain level of failure had to be tolerated and urged regulators not to try to create a capital structure to stop all bank failures; to do so would interfere with lending, he said.

Director Norton inquired whether Committee members' banks underwrote conforming mortgage loans and whether there could be a vibrant community bank mortgage market if Government Sponsored Enterprises and other Federal agencies that can guarantee and buy mortgages did not have capital requirements. Member Hopkins said his bank periodically writes conforming mortgages depending on the interest rate cycle, but did not find the business attractive currently. Member Blanton said his bank originates and sells all of its \$300 million of mortgages per year but was concerned that, under Basel III, his bank would have to allocate capital for potential defaults in the first four months of the mortgage although his bank had not experienced such a default in 20 years. He said such a requirement would reduce the bank's capital for a nonexistent risk. Member Savarese agreed the issue of risk tolerance was critical. She observed that there was a tendency for regulators to create a remedy to address every particular concern and indicated there was insufficient attention to the cumulative impact of regulations on community banks' ability to operate in relation to larger institutions.

Member Williams thought Basel III was an overly formulaic method to set capital; he would prefer to rely on experienced examiners to compare different banks' business models and risks and have discretion in adjusting capital levels to the risk identified. Director Hoenig said the question would then be to determine an acceptable minimum capital level that could then be adjusted; he said such an approach would be both enforceable and simpler and easier for bankers

and regulators to understand. Member Brown inquired whether the acceptable minimum capital just mentioned was meant to guarantee there would be no bank failures. Director Hoenig responded that it was not possible to achieve a goal of no failures because capital could not protect a bank from bad management, although it could protect good management from unanticipated occurrences. He indicated the minimum capital might be set at what the market historically expected banks to have in order to survive downturns, without the deposit insurance safety net. The minimum capital amount could be set (after debate) and then adjusted by examiners in light of a bank's risk profile. Member Hopkins observed he had a strong interest in safe lending because, as a bank shareholder, he experienced any losses that occurred, before the deposit insurance fund. Director Hoenig and Member Hopkins agreed banks would prefer higher capital because, once the capital goes to zero, the bank would not survive.

The Committee stood in recess at 12:16 p.m. and reconvened at 1:47 p.m. that same day.

Ms. Ryan introduced Doreen Eberley, Senior Deputy Director, RMS, Sylvia Plunkett, Senior Deputy Director, DCP, and six Regional Office representatives who led the "Discussion of Current Examination Issues" panel. Ms. Eberley noted the panel's subject matter responded to the Committee's interest in operational risk, which, she said, is not a new FDIC concern, but one increasingly identified as needing improvement or attention in examination reports. She said the panelists would discuss examination findings on a variety of operational risk topics as well as recommendations for mitigating related risk.

John Vogel, the New York Regional Director, spoke about the importance of effective corporate governance, including the need for a strong, largely independent board of directors who: set the bank's risk appetite; establish an organizational framework for operations; and need adequate knowledge and experience to fulfill their roles. Mr. Vogel spoke about enterprise risk management ("ERM"), a subject Member Brown had raised earlier. He said a bank's size and complexity determines the risk management response needed; a community bank needs to understand where its greatest risk exposures are and to continually monitor, measure and mitigate those risks. Mr. Vogel said a community bank can typically handle management of risk areas across an enterprise using cross functional committees that provide varied perspectives to bear on the decision making process and it is not necessary for a bank to invest in vendor software or a consulting service to meet its needs.

Michael Dean, Deputy Regional Director, Atlanta Region, spoke about strategic planning responsibilities. He said the supervisory process has traditionally looked closely to confirm that board members and bank management understand the risks of their business plans and emphasized strategic planning had to be dynamic to deal with uncertainty and rapid change. Mr. Dean observed a bank's long-term goals are often associated with earnings and capital that are designed to maximize shareholder return, but, he said, when a bank is deciding to provide new products or services, it was also necessary to evaluate risks to consumers, and therefore important to include the bank's compliance officer in the strategic planning process. After a strategic plan is developed, it must be communicated and implemented within the organization, Mr. Dean said; changes in strategy should also be communicated to a bank's regulator, who is always available for consultation.

Mark Moylan, Deputy Regional Director, Kansas City Region, spoke about the continuing regulatory focus on IRR as banks make strategic decisions to improve earnings through changing investment strategies or asset and liability mixes. He said there was concern that strategic decisions—for example, to extend asset durations, acquire assets with increased option risk, or to take advantage of widening asset and liability mismatches—were being undertaken without proper due diligence. Mr. Moylan said banks should prudently manage IRR and discussed a variety of steps to do so, including: establishing proper policies and procedures; setting appropriate risk tolerance levels; measuring, monitoring and testing IRR; and updating assumptions used, such as deposit retention rates.

Stan Ivie, the San Francisco Regional Director, discussed earnings. He noted earnings are improving for banks with less than \$1 billion in assets and discussed a variety of earnings' statistics and drivers of improvement. Mr. Ivie said, despite the improvement, the earnings environment remains difficult and noted a concern that, due to the fierce competition for quality loans, some banks were agreeing to riskier rate and term structures (such as offering long-term fixed rates, below market interest rates, non-recourse loans, limited guarantees and relaxed covenants). He also noted some banks were turning to new fee-based services such as third party payment processing to increase yield (discussed below). Mr. Ivie said it was not realistic to expect pre-crisis earnings levels and the FDIC's focus was on the quality of earnings. Banks which incorporate specific risk tolerance levels into their lending policies and remain consistent in their underwriting practices, consistently report higher quality earnings, he said.

Kristie Elmquist, the Dallas Regional Director, spoke about risks associated with third party relationships and risk mitigation techniques. Ms. Elmquist described various reasons financial institutions use third parties, including accessing expertise, improving efficiency, increasing revenues, reducing costs and expanding the customer base. She noted that well-managed relationships can enhance competitiveness, provide diversification and ultimately improve an institution's safety and soundness and compliance management systems. She also observed that improperly managed relationships can present compliance, reputational and operational risks. Ms. Elmquist said institutions should implement effective risk management processes to mitigate these risks. Before entering into a third party relationship, she said, the bank should: confirm the proposed plan is consistent with the bank's strategic plan; conduct due diligence in selecting a third party and during any arrangement; ensure the board approves a written contract specifying each party's obligations; and, develop an appropriate monitoring and reporting program.

Anthony Lowe, the Chicago Regional Director, highlighted the importance of prudent management of third party relationships by describing examples of third party relationships that resulted in a variety of regulatory violations, reputational harm, litigation expense, customer reimbursements and/or civil money penalties. Mr. Lowe said bank boards must conduct their own due diligence; they cannot rely on representations of vendors to ensure that products and programs are compliant. He described various warning signs of elevated risk relationships, including: increased consumer complaints; high volume of activity, fees and returns; promises of high income; vendors that target financially weak banks or those operating under formal enforcement actions; and vendors who use multiple banks to facilitate transactions. Finally, Mr.

Lowe described FDIC outreach efforts to assist community bankers in identifying and managing third party relationship risks.

Ms. Plunkett observed a common theme of the panelists' operational risk presentations included the importance of banks conducting risk assessments, using appropriate personnel to develop policies and procedures, and having monitoring systems to ensure implementation.

Member Savarese said she appreciated the ERM discussion because many banks had been told they needed substantial ERM systems; she inquired where panelists saw opportunities for reducing operational risks. Mr. Vogel confirmed that a bank's risk management function should be appropriate to its complexity and noted a good opportunity banks had to reduce operational risk was by conducting due diligence before entering into third party relationships. He observed such relationships take on consumer risk and that banks are fully responsible for what the third party represents on behalf of the bank –but said some banks have not conducted sufficient due diligence. Mr. Lowe said appropriate due diligence would confirm that third party services are properly aligned with how the bank conducts its business and might help avoid consumer complaints and put-backs. Mr. Moylan said some banks fail to conduct due diligence that would help specify what the bank's responsibilities and costs would be pursuant to the third party relationship, including infrastructure and personnel costs. Ms. Eberley noted banks also may not be conducting sufficient due diligence when entering into lending lines previously not established, such as commercial and industrial or asset based lending.

Member Savarese said her bank was grappling with the proper roles of board auditing and risk committees and inquired whether panelists could share any best practices on the subject. Mr. Vogel said he had seen many banks with effective enterprise risk management and it usually involved an active and informed board of directors with committees that met regularly to address the institution's risks. He added, many banks do not have a separate chief risk officer but have a person who is assigned the responsibility 'to wear the hat of risk officer' and reports to the appropriate committee(s).

Member Urrabazo observed that some community banks may not have the resources to evaluate vendor products involving advanced technology and often rely on state banker associations to conduct due diligence and endorse products. He inquired if the panel had seen problems for banks following such a course. Ms. Elmquist noted there could be vendor products that were beneficial on their own but could be offered by a bank in such a way as to create a Regulation E violation or an unfair or deceptive act or practice, thus, it is incumbent on the bank to perform its own due diligence on the product and its delivery. Members Williams and Brown and Ms. Elmquist and Mr. Moylan discussed examples of potential problems. Mr. Ivie noted that an Internet search would reveal public banking agency orders identifying third party products resulting in regulatory problems. Later, Member Blanton provided an example of his state banker association declining to endorse a vendor product and said small banks put a lot of faith on such endorsements. Member Urrabazo acknowledged that state banker associations could have potential conflicts of interest if vendors offered them incentives for their endorsements; he said, however, that associations want to protect their reputations and concluded there was some due diligence value to their endorsements. Mr. Lowe agreed that trade

associations could provide some portion of due diligence on a product but repeated the need for a bank to review a product in the context of its own operations.

Member Brown discussed an example of his bank developing a strategic plan of particularly high quality which examiners reviewed with, in his view, an emphasis on form over substance. Although he was able to respond easily to the formalities requested, he suggested that there could be more productive ways for examiners to consider a plan's effectiveness. Member Savarese provided an example of Information Technology ("IT") examiners requesting an IT strategic plan. In her view, her bank does not have an IT strategic plan; rather, it has a bank strategic plan with an IT methodology to support it. Similarly, she said her bank has a Compliance Management System ("CMS") because it is a business necessity, not just because the regulator wants a CMS. Member Savarese indicated it is possible that examiners occasionally cannot see the forest for the trees and should remain mindful of the underlying purpose of the various items required of banks. Member Urrabazo said he thought examiners occasionally add to what is required in a bank's policies or procedures, when the additions are not really necessary and also are more than is required of similarly situated competitors.

Member Mehlum inquired about the FDIC's expectations concerning a bank board's role in corporate governance. She expressed concern that her board is expected to be familiar with so much material (her bank provides each director with about 150 pages of various policies) that it keeps them from focusing on key ERM risks or providing strategic assistance. Specifically, Member Mehlum asked whether she had correctly understood that the FDIC expects a bank board to approve vendor contracts; she noted her bank relied on its board annually approving an authority table which gave management teams and individuals the authority to approve contracts up to specified levels. Mr. Vogel said such a practice was acceptable. He added he would expect management to report any contracts that added to the bank's risk profile, even if the particular contract fit within an officer's approved parameters to execute. Mr. Moylan said a concern he had seen in problematic banks was that policies are filed but then not complied with or monitored. He said vendor management could be viewed as part of a board's strategic decision-making, determining how the bank would execute its contractual responsibilities within its business strategy and consistent with the law.

Member Brown commented he was surprised by how often vendors represent their products as "necessary" to comply with regulatory requirements. Acting Chairman Gruenberg inquired, when a vendor asserts that its product is necessary to pass the next examination, whether FDIC staff was in a position to provide guidance on the product's relevance. Mr. Vogel said FDIC staff could help with such questions and would encourage banks to contact the FDIC. Mr. Vogel said occasionally a process that would be necessary for a large bank, for example stress testing, is implied by vendors to be necessary for a community bank whose circumstances would not require it. Ms. Eberley said it was helpful when bankers share with the FDIC what they are hearing about regulatory requirements, either in phone calls or during outreach events. She said the FDIC could address such issues in a public setting if comments were raised.

Ms. Ryan then invited member comments during the "Roundtable Discussion." Member Gray inquired about the recent FIL [FIL 45-2012] concerning preparations for the December 31, 2012, end of unlimited deposit insurance coverage (pursuant to the Dodd-Frank Act) for certain

accounts under the TAG program. Member Gray noted that, because there were bills in Congress to extend the TAG program, it might be premature to notify customers of the program's end; his bank was considering providing notice in early December when legislative actions would be clearer. Director Norton noted that the law terminates the TAG program at year's end and it is unknown what, if any, proposed legislation would pass concerning it. Since banks and the FDIC must operate within the law, Director Norton thought it was appropriate for banks to give customers adequate notice if there may be a marked change in their accounts' insurance coverage. He observed that because some customers with large balances may meet infrequently, such as some nonprofits, a 45-day notice would not be excessive.

Mark Pearce, Director, DCP, said it was a prudent commercial practice to inform customers about the scheduled changes in coverage and noted that some banks had already been in contact with large deposit customers. He and Ms. Eberley said the FIL gave banks flexibility in how to inform their customers; for example, they could use a short announcement on a monthly statement or an individualized notice. In response to a question from Member Hopkins, Mr. Pearce discussed the challenges of identifying which customers should receive a notice if an individualized approach was chosen. Ms. Eberley said the FDIC viewed customer notice as important and that banks have flexibility in how to achieve that goal; she said the FDIC would post further information on a Questions and Answers webpage as it was developed. Later, Member Brown reported that some community bankers felt the FDIC should take additional steps to support extending the TAG program.

Members Savarese, Mehlum, and Blanton noted there was a concern among banks because certain patent holders alleged financial institutions were contributing to patent right infringement by using certain third party vendor services. Ms. Eberley was aware of the issue and suggested further communications outside the meeting.

Noting that this meeting was going to be his last, Member Williams said that he had previously had some concerns about the Committee's value and also had previously wondered if the FDIC had an unstated policy to shrink the number of community banks. He said that through the course of his membership, he became convinced that the FDIC was open to dialogue and had responded to various community bank concerns. He also said that, although he had been persuaded that the FDIC has no policy to shrink the number of community banks, FDIC inaction could still cause a negative result. Member Williams also stated that he was disappointed the FDIC had not weighed in more on credit union expansion into business lending, the TAG program extension, and Basel III.

Member Urrabazo said he was disappointed the FDIC had not spoken against the Durbin amendment (in the Dodd-Frank Act) which harmed consumers as well as community banks. Member Gray, also attending his final meeting, said that he had been increasingly convinced—through the Committee meetings, as well as the various Community Banking Initiative projects—that the FDIC supported the continuation of community banking, an institution which is vital to the country. Members Williams, Gray, Savarese and Blanton said they appreciated Acting Chairman Gruenberg's leadership on community banking, the FDIC staff's research work, and the contributions of the departing members.

Acting Chairman Gruenberg thanked the Committee members for their comments, both positive and critical, and noted critical comments are sometimes more valuable. He indicated the idea of the FDIC having a plan to shrink the number of community banks was an urban (or rural) myth; he said the FDIC viewed its role as assisting all viable institutions, whatever their size, to remain open and serve their communities. Acting Chairman Gruenberg agreed with Member Blanton that community service appeared to be part of the mission of community banks and said the FDIC viewed the community banking initiatives begun in 2012 as representing a beginning rather than an end.

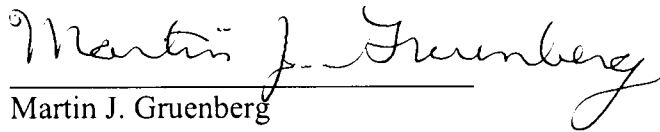
There being no further business, the meeting was adjourned at 3:04 p.m.



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

Minutes
of the
Meeting of the FDIC Advisory Committee on Community Banking
of the
Federal Deposit Insurance Corporation
Held in the Board Room
Federal Deposit Insurance Corporation Building
Washington, D. C.
Open to Public Observation
November 8, 2012 – 8:33 A.M..

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



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