

FDIC Community Banking Initiatives Summary of Roundtable Findings and Examination and Rulemaking Review Activities

Community banks play a critical role in the financial system as well as the overall U.S. economy by extending credit to their communities and fueling job creation. Emerging from the financial crisis, community banks face unique challenges that require specialized and thoughtful attention. In the fall of 2011, the FDIC announced it would undertake a number of initiatives to further the understanding of the evolution of community banks during the past 25 years, current challenges and opportunities for community banks, and implications for the future of community banking.

The FDIC launched the Community Banking Initiative (CBI) in February 2012 with a national conference on community banking. Following the conference, the FDIC's Acting Chairman hosted roundtable conferences between community bankers and senior FDIC staff in each of the FDIC's six regions to hear local concerns. Further, the FDIC's Divisions of Risk Management Supervision (RMS) and Depositor and Consumer Protection (DCP) undertook comprehensive reviews of their examination and rulemaking processes to identify opportunities to make these processes more efficient and effective, without altering the FDIC's supervisory standards. This document summarizes those activities.

Section I summarizes the regional roundtable discussions between FDIC senior management and hundreds of community bankers from March to October of 2012. Section II discusses the actions the agency is taking to address concerns and improve efficiencies and effectiveness in its examination and rulemaking processes.

Section I: Roundtable Discussion Findings

Description of Roundtable Discussions: Roundtable discussions were held in the FDIC's six supervisory regions: Dallas, Atlanta, Chicago, Kansas City, New York, and San Francisco. Approximately 50 - 75 individuals attended each meeting, including community bankers, state banking commissioners, state bank trade association representatives, the FDIC's Acting Chairman, one other director from the FDIC's Board, the FDIC's RMS and DCP Directors, and the FDIC's Regional Director for that region.

Each meeting began with a panel discussion on the financial and operational challenges and opportunities facing community banks. A second panel discussion addressed the regulatory interaction process.

In order to facilitate an open and frank dialogue, no formal transcripts of the meetings were taken. FDIC staff prepared general notes on the topics and concerns discussed (in order to craft the summary findings included in this document) but did not attribute comments specifically to any individual. In addition, the discussions were closed to the public and the media.

Purpose of Roundtable Discussions: The FDIC's Board and senior management believe it is important to hear directly from community bankers, trade organizations and state supervisors regarding significant issues affecting – or likely to affect - community banks. Although the FDIC interacts with community bankers in many venues, the purpose of the Roundtable discussions was to have direct and focused dialogue on the issues and concerns of community

Summary of Roundtable Findings and Examination and Rulemaking Review Activities (continued)

bankers operating in the current environment and the major challenges and opportunities affecting the community bank sector as a whole. The Roundtable format was also intended to provide participants an opportunity to hear and respond to varying views on the same issues from a broad array of attendees.

The insights provided during the Roundtables helped inform other components of the FDIC's 2012 CBI, including the review of examination and rulemaking processes. The information also was used as part of the FDIC's comprehensive research project regarding the evolution of community banking, which is discussed in a separate paper.

Findings from the Roundtables: Topics discussed during the Roundtables varied depending on the interest of the attendees. Therefore, the following should not be considered a comprehensive listing of all topics discussed, but rather a description of the most common issues and concerns noted.

Panel 1: Financial and Operational Challenges and Opportunities Facing Community Banks

- ***General Comments on the Future of Community Banking:*** Overall, the majority of commenters indicated that the community banking model remains viable and that community banks will be an important part of the financial landscape for many years to come. Many tend to believe that a critical factor underlying the success of a community bank is its approach to small business lending. They indicated that community bankers generally know their customers and structured their products and services to meet customer needs. A common sentiment was that community banks will survive and prosper as long as they help the communities they serve.

Many also believe that community banks will see more consolidation in the coming years, but there still will be significant numbers of survivors. Some believe that consolidation is more likely because there are an increasing number of bankers who will decide to leave the industry. Reasons cited by bankers include (but are not limited to):

- lower earnings potential for community banks,
 - decreased stature of profession (“demonization” of the banking industry),
 - onset of fatigue due to economic stress and regulatory requirements,
 - frustrations with perceived regulatory burden, unfair competition (usually from large banks and/or credit unions),
 - changing technology needs, and
 - concerns about attracting new investors.
- ***Loan Demand:*** The general sentiment was that there is an insufficient volume of high quality loans available today in many markets. Bankers tended to indicate that most “new” lending is actually refinancing of credits existing on their own books or those of their competitors.

Some bankers were concerned about “extreme” competition for loans – usually from larger competitors. For example, one banker mentioned his inability to compete with another bank

Summary of Roundtable Findings and Examination and Rulemaking Review Activities (continued)

that offered a 3.75 percent fixed-rate loan for 10 years. Another indicated that entrepreneurs are "...hunkered down; no one wants to take a chance, they are just trying to survive." One banker indicated that "...you have to compromise on structuring and equity to get a deal on the books." Some bankers believe that some of their competitors are taking on additional credit risk (by accepting high loan-to-values) and interest rate risk (by offering longer maturities). Lack of loan demand and lower overall yields were cited as significant contributors to pressured net interest margins at a number of community banks.

Regulation is another factor cited as affecting lending. For example, several bankers indicated they curtailed - or intend to curtail - residential real estate lending due to legal and regulatory requirements perceived as too costly for the banks and their customers.

- *Staffing:* Bankers generally indicated that the current environment has allowed them to more easily attract college graduates – something that is more difficult to do during good economic times. Unfortunately, they also indicated that quality staff is hard to retain once trained. One reason cited is that larger banks recruit staff from smaller banks and offer more benefits to attract them. Bankers also indicated that it is hard to staff certain areas of the bank, especially compliance, information technology, and trust. They struggle to attract employees who can perform a wide variety of jobs.

Some bankers in rural locations indicated that they are experiencing problems hiring and now rely on outsourcing to address complex issues.

- *Technology:* Many bankers noted that customers are demanding more mobile banking technology – but some have concerns with the safety and security of these new technologies. Many indicated that technological changes will be a continuing challenge. Some are addressing this by hiring more technologically savvy staff, while others were looking to core processors for strategic initiatives and leadership in this area.

Several bankers noted that online banking was changing the way community banks serve customers. They indicated there will always be customers who want to come to a branch; however, a growing number of customers visit a branch once to set up an account and then conduct their banking over the Internet.

Even with these changes, some bankers indicated it is important to ensure they keep a "high touch" relationship with customers. They are focusing on technology that supports their business model – not technologies intended to change it.

Bankers are looking for support from regulators in this area, and some indicated a desire to consult with examination staff that was knowledgeable about the information technology component of their business.

Some bankers also indicated that technology changes raise concerns about losing the payments system. They believe that someone needs to look closely at third party providers, such as PayPal, to ensure a level playing field.

Summary of Roundtable Findings and Examination and Rulemaking Review Activities (continued)

- *Capital- Planning Activities:* A majority of bankers indicated capital raises are challenging in the current stressed banking environment, and capital raising in rural markets is generally harder than in urban areas. Most bankers indicated earnings retention was a primary means of augmenting capital going forward. However, some said earnings will be pressured in the future, and they may have a longer-term capital issue if returns on equity are unattractive to potential investors.
- *Interest Rate Risk (IRR):* Some believe the current low-rate environment is leading to a build-up of interest rate risk. They also believe that some community banks were lengthening loan and investment maturities – which may result in additional earnings pressures when rates rise. Several bankers suggested that FDIC provide an updated advisory on interest rate risk.
- *Transaction Account Guarantee Program (TAG):* The majority of attendees indicated a preference for extension of the TAG program. Reasons cited for the preference included uncertainty in the economy and to provide smaller banks an ability to compete against banks that customers may perceive as “too big to fail.” Bankers also raised concerns that a TAG sunset would require them to pledge more securities for municipal deposits.

The above notwithstanding, a number of bankers indicated that TAG should be allowed to expire as they believed it no longer necessary.

Panel 2: Regulatory Interactions

Bankers and other attendees at the Roundtables expressed wide-ranging views on regulatory interactions. Generally, comments can be categorized under four headings - *General Examination Issues, Communication, Regulation, and Technical Assistance*. The summary below organizes banker comments under these headings, and Section II of this document explains FDIC actions taken and being taken to improve or enhance processes.

- *General Examination Issues:* Although the vast majority of comments were favorable regarding individual institution experience with examiners and the examination process, several issues were identified as areas for future focus:
 - Several bankers suggested areas for improvement in the pre-examination process. They tend to believe examiners do not always use the information sent by the bank in response to the pre-examination request letter. In some cases, they indicated information was not always shared with all pertinent FDIC examination staff. Bankers commented that generally the process has improved during the past few months; however, additional improvements are needed.
 - Most bankers indicated the electronic process for sharing information with examiners is adequate, but some indicated that a standardized template with labeled folders would be helpful for exam requests.

Summary of Roundtable Findings and Examination and Rulemaking Review Activities (continued)

- Bankers indicated a strong preference for experienced examination teams familiar with their local areas. A number raised concerns in cases where examiners were less experienced or not familiar with their trade area.
- Some bankers expressed concerns over:
 - the length of time it took to complete an examination and the number of examiners present at a recent examination,
 - inconsistency from one exam to the next when a new issue is identified that wasn't identified previously,
 - examiners enforcing guidance as they would regulations, and
 - “zero tolerance” for violations of consumer laws (e.g., Fair Lending).
- Communication: Bankers were generally looking for clear and timely communication related to specific examinations, as well as other supervisory or regulatory issues outside the examination process.

Bankers generally appreciated ongoing communication during an examination. While generally considered acceptable, there were times – especially early in the crisis – when communications were not considered adequate. The general consensus was that examiners have been giving more timely and comprehensive feedback lately.

A number of bankers also expressed interest in having periodic meetings with Regional Office staff outside the examination process. They viewed such communications as a resource for identifying emerging issues and a sounding board for potential initiatives.

- Regulations: Bankers generally expressed concern over a perceived build-up in new regulations and added scrutiny regarding existing regulations. Bankers indicated that there appeared to have been a shift in examiner focus a couple of years ago, which led to much more scrutiny, including challenges of long standing bank practices. Examples commonly cited as areas of concern included: residential loan originations, commercial real estate appraisals, Home Mortgage Disclosure Act (HMDA) requirements, and Fair Lending documentation. Several bankers indicated that the costs to comply with the increasing number of regulations and/or increased focus on existing regulations was having unintended consequences, such as reduced lending.

Community bankers also generally expressed a desire to move toward a multi-tiered regulatory system. One panelist noted that future regulation requirements should consider asset size and volume of the covered activity.

Bankers also expressed concerns about the timing and rollout of new regulations and guidance. They asked regulators to consider implementation timelines when drafting new regulations and provide a preview of what is in the pipeline. Bankers were looking for flexibility, and several requested phase-in periods for regulations.

Summary of Roundtable Findings and Examination and Rulemaking Review Activities (continued)

A number of panelists expressed concern about the uncertainty created by newly required compliance regulations and their application – especially with the introduction of the Consumer Financial Protection Bureau.

- *Technical Assistance:* Bankers generally viewed technical assistance from regulators positively. FDIC banker/director colleges were cited as worthwhile. One banker indicated assistance on how to implement new regulations would be helpful.

Some bankers indicated it would be helpful for examiners to discuss potential areas of concern arising from new strategies and proposed regulations. They were looking for examiners to share best practices and telegraph changes in examination emphasis earlier in the process.

Some panelists indicated the FDIC should offer more training to bankers, particularly in the compliance area. Others indicated training on more complex topics, such as troubled debt restructurings and recently proposed capital regulations, would be beneficial. One banker stated, “Training is imperative, clarity is key.”

Bankers also were looking for insights on the effects of industry technological changes on their institutions’ risk profiles. A number of bankers requested additional technical assistance in this area and were looking to regulators to communicate expectations as technology evolves.

Summary of Roundtable Findings and Examination and Rulemaking Review Activities (continued)

Section II: Review of Examination and Rulemaking Activities

Purpose and Description of Review of Examination and Rulemaking Activities: The FDIC has undertaken a review of its examination, rulemaking, and guidance processes during 2012 with a goal of identifying ways to make the supervisory process more efficient, consistent, and transparent.

As a part of this process, RMS and DCP solicited feedback from examiners. The Divisions also received significant comments through the CBI Roundtables (discussed above) and the Community Bank Advisory Committee, as well as post-examination surveys and other outreach initiatives. Based on the interests of community bankers participating in the Roundtables in Atlanta and Kansas City, the FDIC also conducted two additional roundtables focused on compliance and consumer protection issues in these regions, led by the DCP Director.

Overall findings from the Review of Examination and Rulemaking Activities: Many of the comments from the FDIC's internal review paralleled comments received from bankers during the Roundtable discussions summarized above. In response to this feedback, FDIC has undertaken a number of actions to improve its processes. The actions are discussed below and are organized the topical headings used in the "Regulatory Interactions" portion of **Section I** above – namely: *General Examination Issues, Communication, Regulation, and Technical Assistance*.

The FDIC considers its review of examination and rulemaking processes as ongoing. Therefore, the listing below represents a current inventory of related actions; additional actions, enhancements, and modifications to our processes likely will occur.

Actions to Address Examination and Rulemaking Review Findings:

General Examination Issues

- ***Pre Examination Process:*** In response to concerns about pre- and post-examination processes, RMS developed a Web-based tool that generates a pre-examination document and information request tailored to a specific institution's operations and business lines. The tool will be used for safety-and-soundness examinations as well as specialty reviews, such as Information Technology, Bank Secrecy Act, and Trust. This tool has been field tested and will be launched nationwide during first quarter 2013. Feedback from bankers who have participated in the field test has been very positive, indicating the information request was specific to the institution and generally shorter than the request list received for their last exam.

DCP also is testing an automated tool to assist examiners in tailoring examination request lists based on the institution's risk profile. The tool will direct the examiner through a series of questions about the institution to ensure only necessary information and documents will be requested. DCP will pilot and implement the tool during first quarter 2013. In addition,

Summary of Roundtable Findings and Examination and Rulemaking Review Activities (continued)

DCP conducted a series of training sessions with examiners and supervisors to refine its examination risk scoping process to ensure that examiners have sufficient time to prepare for examinations, including reviewing materials submitted by the bank in advance of the onsite portion of the examination.

- *Electronic Process for Sharing Information:* The FDIC is improving how information is shared electronically between bankers and examiners and working to standardize naming conventions for files transferred to FDIC via *FDIC Connect*, which will ensure better access for bankers and examiners.
- *Local Examination Teams:* During the financial crisis, the FDIC shifted examination teams from local areas of responsibility to other areas of the country where they were most needed. This allowed the FDIC to more quickly and effectively identify potential problem situations and take action to mitigate emerging risks. As the economy recovers and banking conditions improve, our field offices will return to carrying out supervisory responsibilities locally.
- *Consistency and “Zero Tolerance:”* DCP recently issued new guidance on Classification of Violations for compliance examinations to focus banker attention on areas of greatest concern, such as areas of significant impact on consumers. [Please click here to see additional information on this subject.](#)

DCP also revised procedures for validating of Home Mortgage Disclosure Act (HMDA) data and determining appropriate corrective actions for significant errors. This initiative will help strengthen consistency with other federal bank regulators and make more effective use of supervisory tools and resources. DCP conducted a review of Fair Lending examination processes and procedures to ensure consistency across Fair Lending examinations. DCP also worked with other federal regulators to enhance interagency consistency, as appropriate, in areas such as Community Reinvestment Act and HMDA examinations.

Communication

- *Enhancing Communication during Examinations:* Effective and two-way communication has long been recognized as critical to the success of a supervisory program. On March 1, 2011, the RMS and DCP Directors issued a Financial Institution Letter entitled, “Reminder on FDIC Examination Findings.” Through this letter, the FDIC continues to emphasize the importance of open communication, encourages institutions to provide feedback about the supervisory process, and provides an avenue for direct communication with the Division Directors.

To ensure that communication begins at the start of the examination process, both DCP and RMS have adopted the concept “Know Your Bank” as the basis for tailoring pre-examination requests and examinations to an institution’s risk profile.

Both DCP and RMS are developing Information Packets to provide to bankers at the beginning of the pre-examination process. This information is intended to further open lines

Summary of Roundtable Findings and Examination and Rulemaking Review Activities (continued)

of communication, set expectations, and provide resources to assist bankers with the examination process.

RMS also describes what bankers can expect during each phase of the examination process and offers suggestions for improving and strengthening communication between examiners and bankers in an article published in the Summer 2012 issue of *Supervisory Insights* entitled, “The Risk Management Examination and Your Community Bank.” [Please click here to see additional information on this subject.](#)

- *Enhancing Communication Outside the Examination Process:* To facilitate ongoing communication between examiners and community banks, RMS and DCP revised the interim bank contact process. RMS Regional Office and field staff contact FDIC-supervised institutions between risk management exams to provide an opportunity for institution management to discuss any significant changes and developing issues as well as regulatory guidance and rules that may impact the institution. DCP has established a process for field staff to maintain ongoing contact with the bankers after the conclusion of the onsite examination in the event there are open items to be resolved. Staff will provide periodic updates to the institution until the matter is closed.

Regulations

- *Timing and Pipeline:* In response to requests for up-to-date information about new regulatory issuances, RMS and DCP developed a Regulatory Calendar. The Calendar alerts stakeholders to critical information as well as comment and compliance deadlines relating to changes in federal banking laws and regulations. The Calendar includes Notices of proposed, interim/final rulemakings, and as guidance affecting insured financial institutions. [Please click here to see additional information on this subject.](#)
- *Enhancing Understanding of New Regulations:* The FDIC is also actively taking steps to provide bankers with additional insights on proposed or changing rules and regulations. During 2012, the FDIC hosted national regulatory conference calls and meetings for community bankers to learn about:
 - Proposed Capital Rules: The FDIC held roundtable meetings with bankers in the six regions, recorded a national call, and provided Web-based videos to help community banks understand the potential impact of these rules as well as the comment process. [Please click here to see additional information on this subject.](#)
 - Proposed Mortgage Rule Changes: The FDIC hosted two industry-wide calls regarding proposed mortgage rules expected to be finalized by the CFPB in early 2013.

These meetings and calls generally have received positive feedback from bankers. The FDIC intends to conduct similar types of outreach, particularly in those cases where new regulations may be complex. (See Technical Assistance section below for additional comment.)

Summary of Roundtable Findings and Examination and Rulemaking Review Activities (continued)

- *Clarifying Rule Applicability:* Community bankers have expressed concerns that guidance applicable only to the largest institutions will also be applied to them as a “best practice.” In response, the FDIC instituted a process to ensure all Financial Institution Letters include a *Statement of Applicability* to clarify to community banks whether the specific rules, regulations, and guidance will apply to their operations.

Technical Assistance

- *Assistance with Complex Subjects of Interest:* RMS and DCP management and staff conducted outreach sessions during the year to provide technical training and opportunities for discussion on subjects of interest. One example is the Director and Banker Colleges hosted in each region. These Colleges are held in conjunction with state trade associations and address topics of critical interest to community bankers. [Please click here to see additional information on this subject.](#)

Regions also host targeted training workshops and symposiums, including the Community Bankers Credit Workshop in the San Francisco Region and the Fair Lending Symposium in the Dallas Region. National and regional conference calls were held to discuss a range of supervisory topics, including emerging examination issues. For example, DCP hosted calls on Third-Party Oversight, Mortgage Loan Originator Compensation Rules, and the Fair Lending Examination Process. Each topic was selected in response to questions raised by bankers. Links to these events are available on the newly established DIRECTOR’S RESOURCE CENTER discussed below. [Please click here to see additional information on this subject.](#)

In addition, DCP issues guidance via email about emerging risks identified as part of the examination process; this provides bankers with real-time information between examinations.

- *Centralized Community Banker Resource:* RMS and DCP have taken steps to expand banker use of the FDIC Web site, creating a DIRECTOR’S RESOURCE CENTER. This section of the site provides useful information and resources for directors and officers of FDIC-insured institutions. Topics include:
 - information about factors that contributed to the recent financial crisis, the lingering credit challenges and other critical issues facing certain institutions,
 - links to Financial Institution Letters and regulatory guidance,
 - presentations on supervisory hot topics, and
 - links to banker outreach programs and other events.

In response to banker suggestions, RMS and DCP will add targeted technical assistance videos to the DIRECTOR’S RESOURCE CENTER in early 2013. The first video will address interest rate risk. We also are considering adding videos on significant technological changes. [Please click here to see additional information on this subject.](#)