

COMMUNITY BANKING CONNECTIONS[®]

A SUPERVISION AND REGULATION PUBLICATION

A Message from Governor Bowman

by Governor Michelle Bowman

First Issue 2020

Beginning with this edition, I will regularly contribute to our *Community Banking Connections* publication, to discuss topics that affect the supervision of community banks. For this edition, I will provide some background on my perspective as a community banker and state regulator, discuss the importance of open communication, and preview a few initiatives that are currently underway.

It has been just over a year since I was sworn in by Chair Powell, to serve an unexpired term in November 2018, as the first Governor to fill the role designated by Congress for someone with community banking experience on the Federal Reserve Board (Board).¹ Since then, I have been working to ensure that the community bank perspective is considered in the Board’s deliberations. On February 1, 2020, I began serving a full fourteen-year term ending in 2034, and I look forward to continuing this important work.

Prior to joining the Board, I was a community banker and more recently had the privilege to serve as the Kansas State Bank Commissioner. My approach as a state bank regulator was to treat every institution and consumer fairly and respectfully, and to foster open communication between our staff and regulated entities. As a community banker, I supported local businesses, our community and consumers. Community banking influences who I am, and how I approach banking regulation and supervision.

As a Governor, my objective is to ensure our country maintains a safe and sound financial system, with strong consumer protections, and widespread access to financial services. I believe that a thriving community bank sector is absolutely essential to achieving these objectives. These goals and values are precisely those I held as a banker, when my focus was serving customers and the community.

I believe that supervision is most effective when the communication between bankers and regulators is open and honest. It must be two-way communication. Supervision should be transparent, accountable, and fair. One way that supervisors can provide more effective supervision for community banks is through improved communication and technical assistance programs.



Governor Michelle Bowman

This was an important message included in my remarks at the February 2020 American Bankers Association Community Bank Conference.² I have seen how more active and engaged communication with the industry can result in a more balanced and trusted relationship.

Since assuming my responsibilities at the Board, I have traveled widely and listened closely to many stakeholders—bankers, consumers, small business owners, and community leaders. I also host meetings with state bank associations, and have been engaged through some of the Federal Reserve’s formal programs such as the Community Depository Institutions

² See <https://www.federalreserve.gov/newsevents/speech/bowman20200210a.htm>.

¹ Created by statute in 2015, see Terrorism Risk Insurance Program Reauthorization Act of 2015, Pub. L. No. 114-1, 129 Stat. 3.

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Advisory Council and Partnership for Progress.³ Additionally, the Federal Reserve hosts “Ask the Fed” sessions, which are interactive webinars that are an opportunity for supervisors to provide guidance and answer questions directly from bankers. I look forward to building upon these foundational programs to broaden communication directly to bankers on key issues.

In addition to improved outreach and communication, adjustments to supervision and regulation programs that address excessive burden on community banks are also under consideration. Two ways to do this are: through greater risk tailoring in community bank examinations, and by harnessing the unique benefits of the Federal Reserve’s decentralized structure.

The Federal Reserve uses a risk-focusing model known as Bank Exams Tailored to Risk, to help quantify the risks posed by a bank’s activities and scale the examination accordingly.⁴ While much progress has been made on the financial aspects of each bank examination, at my direction Federal Reserve staff are taking additional steps to tailor and improve our examination processes to be more efficient for lower-risk banks, especially in the nonfinancial risk areas, including Bank Secrecy Act/Anti-Money Laundering compliance.

The Federal Reserve’s decentralized structure—with supervision delegated to and conducted by the 12 regional Reserve Banks—is a key feature of the system. This connection to local economies enables the Federal Reserve to fulfill both our supervisory and monetary policy responsibilities. Our geographic diversity

lends itself well to cultivating positive relationships between our community banks and their Reserve Bank. Reserve Banks have the local expertise to best understand the communities and the institutions they supervise. Through empowered Reserve Banks, we optimize our supervision to ensure it adapts to the on-the-ground realities of an evolving industry and changing consumer expectations, while maintaining the goals of safety and soundness, and consumer protection.

I also chair the Board’s Subcommittee on Smaller Regional and Community Banking. The subcommittee provides guidance to staff and makes recommendations to the Board on supervisory and regulatory matters related to safety and soundness issues that have broad implications for smaller institutions for which the Board has specific statutory authority. I have also assembled a working group of seasoned supervisors from across the Federal Reserve System to review supervisory and regulatory proposals with a narrow focus on the impact to community banks. It is clear we must strive to achieve a fair balance between safety and soundness and reducing unnecessary regulatory burden, in order to ensure that community banks have the capacity to serve the needs of their communities.

I look forward to hearing your feedback. If you have suggestions or would like to provide feedback on this publication, please email: administrator@communitybankingconnections.org. Copies of my prior speeches can be found on the Board’s public website, www.federalreserve.gov. ■

³ <https://www.federalreserve.gov/aboutthefed/cdiac.htm>; <https://www.fedpartnership.gov/>.

⁴ See Supervision and Regulation Letter 19-9, “Bank Exams Tailored to Risk,” available at <https://www.federalreserve.gov/supervisionreg/srletters/sr1909.htm>.

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Community Bank Supervision: Facilitating “Right-Sized” Supervision for a Diverse Portfolio

by Kevin J. Stiroh, Executive Vice President, Supervision Group, Federal Reserve Bank of New York



Kevin J. Stiroh

At the Federal Reserve Bank of New York (New York FRB), we supervise a diverse range of financial institutions in the Second District. This includes small community banks of significant importance to their communities and local economies, as well as some of the largest and most systemically important banks in the United States. The diversity in financial

institution size and complexity provides us with a unique perspective that a one-size-fits-all methodology for supervision is not an optimal approach. As discussed widely in recent years, we need to tailor our supervisory approach to the risks of individual institutions in order to be as effective as possible.

Overview of the Second District

The Second District covers New York State, northern New Jersey, southwestern Connecticut, Puerto Rico, and the U.S. Virgin Islands.¹ The financial institutions range in size from \$30 million to more than \$2 trillion in total assets at the consolidated organization level.

The Federal Reserve defines community banking organizations (CBOs) as those financial institutions with total consolidated assets of less than \$10 billion. As of June 30, 2019, the Second District had 197 CBOs with assets totaling \$294 billion. Of those CBOs, 17 are state member banks with the Federal Reserve serving as their primary federal regulator.

The Second District state member banks had approximately \$28 billion in consolidated assets as of June 30, 2019, or

an average of less than \$2 billion in assets per firm. Our largest state member bank has total consolidated assets of approximately \$5 billion and the smallest has approximately \$30 million. The majority of Second District state member banks are headquartered in upstate New York; the rest are in areas surrounding New York City.

The business models for the state member banks primarily include traditional banking activities, such as retail deposit acquisition and retail and commercial lending. Several are also engaged in, or evaluating, business activities outside of the core lending and deposit-taking activities. For example, some engage in asset wealth management and trust activities, and others are active in the cryptocurrency markets. It is notable that while Second District state member banks serve a diverse set of consumers and businesses in many industries, when compared with other Federal Reserve Districts, the Second District state member banks have a lower concentration of agricultural lending and a higher concentration of commercial real estate (CRE) lending.

Second District community state member banks are predominantly closely held private institutions. From a supervisory perspective, this type of ownership structure requires careful succession planning among family members. Issues frequently discussed with bank management include key-person risk, planning for the next generation of leadership, and remaining closely held.

Fostering a Robust Dialogue

A key strategy that informs the New York FRB’s community bank supervisory approach is an ongoing dialogue with local bankers. This dialogue supplements insights gained from supervisory activities and enables a deeper understanding of current and emerging themes impacting these banks and the communities they serve.

¹ More information about the areas the District serves is available at www.newyorkfed.org/regional-economy.

The New York FRB utilizes recurring and ad hoc outreach initiatives to encourage such dialogue and receive firsthand accounts from bankers in the Second District. For example, since 2002 the New York FRB has hosted its annual Community Bankers Conference. At this signature event, supervisors have the opportunity to interact with community bankers and learn about significant opportunities and challenges for their businesses and communities. The conference brings together community bank stakeholders from across the Second District and enables conversations that inform diverse views and perspectives. The two most recent conferences focused on the changing environment for community banks, with the 2018 theme of “Navigating Future Risks for Community Banks”² and the 2019 theme of “On the Horizon for Community Banks.”³ I find these conferences and related dialogue to be extremely valuable and an important part of our supervisory responsibilities.

“ As discussed widely in recent years, we need to tailor our supervisory approach to the risks of individual institutions in order to be as effective as possible. ”

Second District CBO Themes

These bankers conferences and recurring supervisory interactions provide insights into what is on the minds of community bank management and directors. The current state of regulation, the economy, and the evolving competitive environment are prominent macro themes in these conversations. More specifically, bankers have highlighted:

- **Investment in technology.** The most prominent and recurring theme in our conversations is technology and

² Read the introductory remarks for the 2018 conference at www.newyorkfed.org/newsevents/speeches/2018/sti180418.

³ The opening remarks for the 2019 conference are available at www.newyorkfed.org/newsevents/speeches/2019/sti190404.

a desire to invest in the enhancement of client service delivery, administrative efficiency, and financial processes. A key consideration for CBOs regarding technology investment is the need to balance potential benefits of the investment with the costs of the technology investment relative to the size of the CBO.

- **Acknowledgment that the world is rapidly changing.** Changes in the banking environment are attributable to technological change, demographic change, and generational change. CBOs recognize the increased competition from banks and nonbank entities and the millennial generation’s technological preferences and proficiencies. These are key trends to consider during a CBO’s strategic planning initiatives.
- **Delivery of traditional business in new and innovative ways.** New York FRB supervision staff receives an increasing number of inquiries relating to mobile banking and other internet-based methodologies for enhancing client service offerings. The inquiring banks express a desire to provide value-added services to their customers but acknowledge that adding mobile and internet capabilities creates additional risks, most notably in the context of cybersecurity. The enhanced digital offerings provide an opportunity for community banks to match, or surpass, service offerings provided by out-of-region banks and nonbank entities that compete for the CBOs’ existing customers.
- **Understanding of fintech and its impact on banking.** Technology investment conversations often touch on fintech and how emerging or disruptive technologies present both threats and opportunities for the CBO landscape. Moreover, this mix can vary across business lines and geographies. Second District CBOs are in the early phase of evaluating fintech opportunities, including strategic partnerships.
- **Exploration of nontraditional lines of business.** Community bankers have noted that emerging technologies, and changing regulatory and legal environments, have created opportunities to enhance existing service offerings or develop new service offerings for clients. Recent examples of inquiries from Second

District community banks have been related to providing cryptocurrency services.

- **Compliance with regulatory and accounting standard changes.** Community bankers are concerned about meeting expectations relating to current expected credit loss (CECL) implementation.⁴ The Federal Reserve conducted outreach events such as “Ask the Fed” webinars and other mechanisms to support the implementation of CECL. Importantly, the Federal Reserve Board has also implemented a three-year phase-in for CECL implementation, which will allow for monitoring as the new accounting standard from the Financial Accounting Standards Board (FASB) goes into effect. On October 16, 2019, the FASB voted to extend the CECL implementation timeline for smaller reporting companies to fiscal years beginning after December 15, 2022. The Federal Reserve will continue to provide Q&A support on this topic for bankers.

We will continue to engage with bank management and directors to stay informed on emerging themes relevant to the communities they serve and the Second District. These themes help us identify key areas of supervisory focus when planning examinations.

Risk-Based Supervision

The diversity of Second District community banks can be observed across many dimensions: asset size, earnings, number of branches, and many other financial, strategic, and geographic factors. As a result, we use a tailored supervisory approach for each bank based on its risk profile.

The Economic Growth, Regulatory Relief, and Consumer Protection Act, also known as S.2155, became law on May 24, 2018. The Federal Reserve Board has implemented provisions of the legislation that affect community banks, including:

- raising the total asset size threshold for banks to qualify for an 18-month examination cycle from \$1 billion to \$3 billion;⁵
- streamlining the regulatory reporting requirements for firms with less than \$5 billion in assets by introducing the

⁴ For more information about CECL, see the CECL Corner on page 16 of this issue of *Community Banking Connections*.

⁵ More information can be found at www.federalreserve.gov/newsevents/pressreleases/bcreg20181221c.htm.

FFIEC 051 short form Call Report;⁶

- excluding community banks from the Volcker rule;⁷
- raising the asset threshold for the Small Bank Holding Company and Savings and Loan Holding Company Policy Statement to \$3 billion in total consolidated assets;⁸ and
- adopting the community bank leverage ratio that will enable banks meeting certain criteria to qualify to utilize a simplified capital adequacy framework.⁹

The Federal Reserve has also introduced the Bank Exams Tailored to Risk (BETR) program¹⁰ to tailor state member bank examinations to reflect the level of risk present at the supervised institution. BETR is a risk-focused program aimed at streamlining supervisory work programs for low-risk activities while providing more supervisory focus on high-risk activities. Our expectation in the Second District and throughout the Federal Reserve System is that BETR will ease the examination process for well-managed banks with appropriate risk management processes and allow us to use a tailored approach that is better suited to the unique characteristics of each bank. The recent changes align the supervisory approach with the conclusion that there is not a one-size-fits-all approach.

We strive to achieve the balance between regulatory efficiency while being vigilant to bank-specific and System-wide risks. As part of our supervisory work, we are closely monitoring the following risk themes:

- **Continued growth in CRE lending.** CRE lending for all Second District community banks has increased from

⁶ For details, see www.federalreserve.gov/newsevents/pressreleases/bcreg20190617a.htm

⁷ Find a more in-depth explanation at www.federalreserve.gov/newsevents/pressreleases/bcreg20190709b.htm.

⁸ See www.federalreserve.gov/newsevents/pressreleases/bcreg20180828a.htm.

⁹ More information is available at www.federalreserve.gov/newsevents/pressreleases/bcreg20191029a.htm.

¹⁰ See Vadim Bondarenko, Chris Henderson, and Matthew Nankivel, “Improved Risk Identification Helps Tailor Examinations to Banks’ Risk Level,” on page 12 of this issue of *Community Banking Connections*. Also, see Supervision and Regulation letter 19-9, “Bank Exams Tailored to Risk (BETR),” at www.federalreserve.gov/supervisionreg/srletters/sr1909.htm.

\$58 billion as of the fourth quarter of 2015 to nearly \$80 billion as of the fourth quarter of 2018. That is an aggregate growth rate of 37 percent. Second District state member banks have exhibited a similar growth rate of 35 percent, increasing from \$6 billion as of the fourth quarter of 2015 to more than \$8 billion as of the fourth quarter of 2018.

- **Improved risk management over CRE concentrations.** The demographics of the Second District, particularly the New York City metropolitan area and associated population density, are such that there is a high demand for multifamily housing and office space. As the aggregate CRE levels have increased, examiners have observed risk management practices that are commensurate with the growing concentration risks.

“ The depth of knowledge gained by Reserve Bank staff from discussions with local bankers is invaluable. ”

- **Diversified lines of business.** Second District CBOs are exploring new service offerings with the primary goal of supplementing income with fee-based revenue sources. One of the noted offerings is asset wealth management services; state member banks are now managing and administering more than \$14 billion in assets related to these services.
- **Liquidity risk.** Second District CBO deposit balances have shown signs of competitive pressure with a shift away from more traditional deposits, as savings account balances have decreased and reliance on time deposits has increased.
- **Vendor management.** CBOs continue to rely on third-party service providers for support in specialty areas such as audit, loan review, and core processing.

Prudent oversight of these relationships should include a clear understanding of the contractual arrangement, the roles and responsibilities of each party, and a contingency plan addressing service providers' inability to meet contractual obligations.

Conclusion

Our supervisory and outreach approach for Second District community banks encourages dialogue and an appreciation of the unique profile of each firm.

The depth of knowledge gained by Reserve Bank staff from discussions with local bankers is invaluable. Our team accomplishes this through bank-specific discussions during examinations and periodic on-site visits, and at broader events such as our Community Bankers Conferences. My onsite visits and ongoing updates from the examination team provide excellent opportunities to better understand the market dynamics of the local community and the issues faced by bankers serving the financial needs of their communities. I look forward to opportunities to visit Second District community bankers and to learn about the unique attributes of each bank.

Our efforts to engage with Second District community banks are aligned with the following principles:

- Every Second District CBO is unique.
- The Federal Reserve System — including the New York FRB — supports tailored, risk-focused supervision for CBOs.
- The New York FRB is committed to providing forums for community bank education and collaboration.
- We support measured and controlled risk-taking at community banks.
- Community banks fill a need in today's economy, and our supervisory efforts are intended to ensure their safety and soundness so that they can continue to play a vital role in the local economies. ■

Prepare Your Community Bank to Surf the Silver Tsunami

by Jeanne Rentzelas, Senior Vice President and General Counsel, Federal Reserve Bank of Philadelphia, and Larry Santucci, Advisor and Research Fellow, Consumer Finance Institute, Federal Reserve Bank of Philadelphia

If you are reading this article, there's a good chance you've noticed that your customer base is aging. In 2011, the first of the baby boomers turned 65. Since then, about 10,000 more have reached 65 every day, and this pace will continue until 2029.¹ This *silver tsunami* of retirees will challenge conventional banking norms, changing the way community banks and other financial institutions serve their customers. This article discusses some of the changes banks may consider implementing and how community banks are uniquely positioned to safeguard the financial health of the U.S. senior population.

Older Adults' Financial Needs

An aging population has different financial needs than a younger one. Older customers may be more likely to visit a bank branch than younger ones and thus value the convenience of local bank branches. Some older adults will experience physical limitations that may make it more difficult for them to climb stairs, stand in long lines, or read small print. And many will experience *diminished financial capacity*, a degradation of their ability to manage their money and make sound financial decisions. Diminished financial capacity is caused by a loss of cognitive function, typically due to the onset of Alzheimer's disease or other diseases causing dementia. People with diminished financial capacity can have trouble paying their bills and remembering their account balances and are also more likely to be victimized by fraud schemes or financially exploited by friends or family members. The financial consequences can be catastrophic; the average financial exploitation victim loses \$120,000 per exploitative event.² The value at risk is staggering. The Employee Benefits Research Institute estimates that baby boomers and current retirees hold almost 70 percent of all U.S. financial assets, or about \$66 trillion.³

¹ Russell Heimlich, "Baby Boomers Retire," Pew Research Center, December 29, 2010, available at www.pewresearch.org/fact-tank/2010/12/29/baby-boomers-retire/.

² Jilene Gunther, "BankSafe Safeguards Against Exploitation," AARP Public Policy Institute, available at www.aarp.org/ppi/info-2018/bank-safe.html.

³ Larry Santucci, "Aging, Cognition, and Financial Health: Building a Robust System for Older Americans," Conference Summary, Federal Reserve Bank of Philadelphia, September 2019, available at www.philadelphiafed.org/-/media/consumer-finance-institute/payment-cards-center/publications/conference-summaries/2019/c-2019-aging-cognition-and-financial-health.pdf?la=en.

A Role for Community Banks

Community banks have local roots that run deep. The relationships bankers have with their customers can go back generations. Simply put, community banks know their customers, and their customers know them. With such long-standing relationships, community banks are uniquely positioned to notice changes in a customer's behavior, interactions with family and friends, or banking patterns. These relationships also help to align the success of community banks to the continued financial success of their customers. Taking action to protect against elder financial abuse preserves those long-standing relationships and helps build trusting relationships with the adult children who will one day be retirees themselves. On the other hand, not taking action can lead to higher operating expenses and fraud losses, lost business, and reputational damage.

Several community banks have been at the forefront of the fight against elder financial fraud and exploitation. A 2016 AARP white paper recognized Bank of American Fork's work with the Utah Division of Aging and Adult Services to implement a five-step strategy to help prevent financial exploitation and improve seniors' banking experiences.⁴ In 2016, the American Bankers Association (ABA) Foundation presented Montecito Bank & Trust, a locally owned California community bank, with a Community Commitment Award for its work to protect older Americans from financial abuse.⁵ The ABA Foundation has also honored Bank of the Rockies, National Association, for its programs promoting elder fraud prevention and awareness.⁶

⁴ Jilene Gunther, "Preventing Exploitation: Five Banks Leading the Fight," AARP Public Policy Institute, April 2016, available at www.aarp.org/content/dam/aarp/ppi/2016-03/Preventing-Exploitation-Five-Banks-Leading-The-Fight.pdf.

⁵ Monica C. Meinert, "Six Banks to Receive Community Commitment Awards," *ABA Banking Journal*, September 22, 2016.

⁶ ABA Foundation, "2017 ABA Foundation Community Commitment Awards."

Six Sound Practices Financial Institutions Can Consider to Address Elder Financial Abuse

Federal agencies and other organizations have offered guidance to assist the financial services community in efforts to prevent elder financial abuse and to intervene when it occurs (see Resources for Preventing Elder Financial Abuse on page 10). In a recent Philadelphia Federal Reserve discussion paper,⁷ the authors reviewed information provided by these and other sources and created a list of six considerations for financial institutions to help detect and prevent elder financial abuse.



1. Train frontline staff on how to recognize and react to signs of diminished financial capacity, elder financial fraud, and exploitation.

The signs of diminished financial capacity, elder financial fraud, and exploitation are often visible to a trained eye. Frontline staff, branch managers, call center employees, and others can be trained to recognize the signs of existing or imminent financial trouble. Effective training programs can help staff identify red flags, provide examples of elder fraud scams, explain what actions bank employees can take once suspicious activity is detected, and clearly delineate the roles and responsibilities of management and staff.

⁷ Jeanne Rentzelas and Larry Santucci, “Combining Forces to Combat Elder Financial Victimization: How Consumers Can Avoid the Pitfalls of Cognitive Aging and What They Should Be Asking Their Financial Institutions,” Federal Reserve Bank of Philadelphia Payment Cards Center Discussion Paper, June 2018, available at www.phil.frb.org/-/media/consumer-finance-institute/payment-cards-center/publications/discussion-papers/2018/dp18-02.pdf.

Training need not be costly. Financial institutions have access to a variety of free or low-cost training, including a program launched by the AARP in May 2018, the North American Securities Administrators Association’s (NASAA) SeniorSafe Training program, and the Senior Investor Protection Toolkit from the Securities Industry and Financial Markets Association (SIFMA).⁸

Scammers are always coming up with new scams and twists on old ones. To keep up with the latest scams, banks can leverage the Federal Trade Commission, the National Consumers

League, and the AARP, all of which track scams and post alerts to their websites.⁹ The AARP’s Fraud Watch Network provides access to information about identity theft, investment fraud, and the latest scams, while its Fraud Watch Helpline fields calls from consumers seeking assistance and reporting new scams. Community bank staff who are alert to the latest scams will be better positioned to detect and prevent fraud and exploitation, as well as to pass along valuable information to their bank customers.

2. Repurpose existing bank systems to detect unusual transactions.

While many of today’s older adults prefer face-to-face transactions with a bank teller, automated surveillance tools may also be considered as internet-savvy baby boomers age into retirement.¹⁰

Continuous monitoring and analysis of transaction data can help financial institutions identify, flag, and address unusual activity. For example, sudden activity on a rarely used

⁸ The NASAA’s SeniorSafe Training program, unveiled in March 2016, is available at www.nasaa.org/39147/nasaa-unveils-training-program-combat-elder-financial-abuse/ to all members of the banking and securities industries. As part of its free Senior Investor Protection Toolkit (www.sifma.org/wp-content/uploads/2017/07/toolkit-client-protection-playbook.pdf), SIFMA offers resources to help brokers and financial advisers identify the signs of fraud and financial exploitation. Beginning in May 2018, the AARP launched a program for its newly developed BankSafe training platform, aimed at teaching frontline staff, supervisors, and compliance officers how to detect and prevent exploitation. See www.aarp.org/ppi/banksafe/.

⁹ See www.consumer.ftc.gov/features/scam-alerts, www.fraud.org/, and www.aarp.org/money/scams-fraud/.

¹⁰ Susan Burhouse, Karyen Chu, Ryan Goodstein, Joyce Northwood, Yazmin Osaki, and Dhruv Sharma, “2013 FDIC National Survey of Unbanked and Underbanked Households,” Federal Deposit Insurance Corporation, October 2014, available at www.fdic.gov/householdsurvey/2013report.pdf. The authors found that 54.7 percent of households aged 65 or older primarily used bank tellers to access their accounts.

account, transaction patterns inconsistent with that of an older consumer, and large daily ATM withdrawals are potential signs of financial exploitation.¹¹ Banks may be able to repurpose existing business systems, such as anti-money-laundering (AML) and fraud detection software, to monitor customers' day-to-day transactions for abnormalities. AML software typically contains an integrated transaction-monitoring module that can be repurposed to detect elder fraud and abuse.

3. Provide account holders and their financial caregivers with tools to help them detect suspicious account activity.

By providing tools such as read-only access to online banking, convenience accounts (a special type of joint account), and suspicious activity alerts, banks can empower older customers and their financial caregivers to help monitor the older person's accounts for signs of fraudulent or unusual activity. Read-only account access requires one or more trusted people to have access to view the older person's online banking account via a separate set of credentials (username and password). The trusted person cannot authorize any transactions but will be able to see account activity. Joint accounts or convenience accounts should be encouraged only when the older adult has confidence that the trusted party being added to the account will always act in the interest of the original account holder. If there is any doubt about whether the additional party is sufficiently trustworthy, these account types may not be viable options.¹² Account alerts can be especially helpful for account holders suffering from cognitive impairment, as they enable financial caregivers to spot transactions authorized by the account holder that may not be in the person's financial interest.

4. Prepare a trusted contact form and develop policies governing when an employee may reach out to the person listed on the form.

When bank employees believe an older person is the victim of fraud, they might not be able to convince the person to cancel a transaction. This often occurs when the older adult is the victim of a scam, such as:

- the Grandparent Scam, in which a scammer calls a grandparent, pretending to be a grandchild in trouble and in need of money;¹³
- the Lottery Scam, in which an older person receives an email, phone call, or letter saying that he or she has won the lottery but must pay a tax or fee, often by prepaid card,

before receiving the winnings;¹⁴ and

- the Romance Scam, in which a scammer establishes a relationship with someone to gain his or her trust, quickly proposing marriage before ever meeting in person. Eventually, the scammer begins asking for money.¹⁵

In those situations, the bank can reach out to someone the older adult trusts to try to convince the older adult to reconsider sending money to the scammer. For that to happen, the bank must have both the trusted person's contact information as well as the account holder's consent to contact that person. A financial institution that does not have a trusted contact on file for a particular account may have to allow a suspicious transaction to go through. Banks can make a reasonable effort to obtain the name and contact information for a trusted contact when opening a new account or when updating the customer's account information. Although consumers may want to keep their financial information completely private, doing so may become an obstacle in preventing or mitigating financial harm. When reaching out to the trusted contact, consistent with relevant financial privacy laws, bank staff members may be limited in what they may disclose. The information provided to the trusted contact may need to be as vague as, "bank staff has reason to believe that the account holder may be the current target of a scam — you might want to speak to the account holder to see if he or she will give details to aid you in providing helpful advice."

5. Institute policies to prevent an agent under a power of attorney from abusing access to an older person's finances.

A durable power of attorney is a valuable tool for a person planning for the possibility of cognitive impairment. Establishing this power of attorney ensures that someone else can make decisions for an older adult who is unable to make independent financial decisions. However, even the most well-intentioned power of attorney can turn into a license to steal.¹⁶ In certain situations, abusing a power of attorney may not be easily pursued as a crime, such as in situations in which the agent makes gifts of cash or other assets to him- or herself or someone

¹¹ See "How Financial Institutions Can Prevent Elder Financial Exploitation," Narmi Inc., 2018.

¹² Adding more than one trusted person to the joint or convenience account arrangement may mitigate the risk of one person acting unilaterally, assuming that collusion among the trusted persons added is unlikely.

¹³ National Consumers League, "Fraud Against Older Adults: Grandparent Scams," fraud.org, 2018, available at https://www.fraud.org/grandparent_scams.

¹⁴ "Sweepstakes and Lottery Scams," AARP.org, accessed November 7, 2019.

¹⁵ "Romance Scams: Online Imposters Break Hearts and Bank Accounts," FBI.gov, February 13, 2017.

¹⁶ Lori A. Stiegel and Ellen V. Klem, "Power of Attorney Abuse: What States Can Do About It," AARP Public Policy Institute, *Research Report*, November 2008.

Resources for Preventing Elder Financial Abuse

Consumer Financial Protection Bureau (CFPB), “Recommendations and Report for Financial Institutions on Preventing and Responding to Elder Financial Exploitation,” (full report), March 2016

https://files.consumerfinance.gov/f/201603_cfpb_recommendations-and-report-for-financial-institutions-on-preventing-and-responding-to-elder-financial-exploitation.pdf

CFPB, “Advisory for Financial Institutions on Preventing and Responding to Elder Financial Exploitation,” (companion advisory to the CFPB’s full report), March 2016

https://files.consumerfinance.gov/f/201603_cfpb_advisory-for-financial-institutions-on-preventing-and-responding-to-elder-financial-exploitation.pdf

CFPB and Federal Deposit Insurance Corporation, “Money Smart for Older Adults Resource Guide,” September 2018

https://files.consumerfinance.gov/f/documents/201703_cfpb_money-smart-for-older-adults-resource-guide.pdf

The Federal Reserve System, “CA letter 13-14: Interagency Guidance on Privacy Laws and Reporting Financial Abuse of Older Adults,” September 2013

www.federalreserve.gov/supervisionreg/caletters/caltr1314.htm

National Community Reinvestment Coalition, “Guide to Age-Friendly Banking Products, Services, Protections, and Resources for Older Adults,” 2011

<https://ncrc.org/wp-content/uploads/2017/11/Guide-to-age-friendly-banking-03.pdf>

Securities Industry and Financial Markets Association (SIFMA), “Senior Investor Protection Toolkit”

www.sifma.org/resources/general/senior-investor-protection-toolkit/

else without specific authorization from the principal or when the agent engages in transactions that go against the principal’s unwritten, but known, wishes.¹⁷ Banks can train customer-facing staff to recognize potential power of attorney abuse and, when it is detected, to escalate the issue to a manager specifically trained to address the issue.

In addition to being alert to possible power of attorney abuse, banks also need to be aware that their employees might refuse to honor a valid power of attorney for reasons other than suspected fraud or abuse. The CFPB reports that financial institutions sometimes refuse to accept a power of attorney that is valid under state law.¹⁸ The financial institution may object because its own power of attorney form was not used, which is typically not a valid basis for objection under state law. Banks and other financial institutions may want to ensure that their employees are well trained both to honor a valid power of attorney and to detect signs of exploitation so that the purposes of the power of attorney are properly effectuated.

6. Report suspected financial abuse by a caregiver, trustee, guardian, or attorney-in-fact to local law enforcement and adult protective services (APS).¹⁹

Many older adults have family members or other trusted persons they can rely upon to assist with banking and investment decisions. Sometimes, what begins as an honest caregiving effort can turn into a financially exploitative situation. When older adults are financially exploited, perpetrators are usually family members or someone they trust.²⁰ As mentioned previously, a single case of financial exploitation can cause tens of thousands of dollars of lost savings. Early intervention by law enforcement and APS is critical in preventing a perpetrator from accessing savings. Unfortunately, the laws governing financial institutions’ reporting obligations are murky and vary from state to state. Some financial institutions have a policy of reporting all cases of suspected elder abuse to APS, whether mandated by state law

¹⁷ Linda S. Whitton, “National Durable Power of Attorney Survey Results and Analysis,” National Conference of Commissioners on Uniform State Laws, October 29, 2002.

¹⁸ “Recommendations and Report for Financial Institutions on Preventing and Responding to Elder Financial Exploitation,” Consumer Financial Protection Bureau, March 2016.

¹⁹ An attorney-in-fact is an agent authorized to act on behalf of another person but not necessarily authorized to practice law. See Legal Information Institute, “Attorney-in-Fact,” accessed November 7, 2019.

²⁰ National Adult Protective Services Association, “Get Informed: Elder Financial Exploitation,” accessed November 7, 2019.

or not.²¹ Banks that do not report suspected elder abuse provide opportunities for the perpetrator to steal additional savings. This may also affect the victim's ability to recover any of the stolen funds through the legal system, since it provides the perpetrator with more time to spend the stolen funds.²² After following the bank's internal policies and procedures for potential unusual activity, a sound practice is to report the suspected elder abuse to APS regardless of what is legally required.

Concluding Thoughts

Everyone can do more to detect, respond to, and prevent financial losses for older consumers. Changes in cognitive abilities continue to cost older Americans billions of dollars each

year.²³ This is money they simply cannot afford to lose: A single financial exploitation event can result in a loss of hundreds of thousands of dollars and can have adverse consequences for physical and functional health.²⁴ Distinguished by their close ties to the communities and customers they serve, community banks can leverage those personal relationships to detect and prevent financial losses resulting from diminished financial capacity, fraud, and exploitation, and serve as a model for the financial services industry to follow. ■

²¹ Ronald C. Long, "Elder Financial Abuse," *Elder Abuse and Its Prevention: Forum on Global Violence Prevention*. Washington, D.C.: National Academies Press (2014).

²² Sandra L. Hughes, "Can Bank Tellers Tell? Legal Issues Related to Bank Reporting of Suspected Elder Financial Abuse," American Bar Association, 2003.

²³ MetLife, "The MetLife Study of Elder Financial Abuse: Crimes of Occasion, Desperation, and Predation Against America's Elders," June 2011. This study estimates that older victims lose at least \$2.9 billion annually from financial abuse.

²⁴ See Jaelyn S. Wong and Linda J. Waite, "Elder Mistreatment Predicts Later Physical and Psychological Health: Results from a National Longitudinal Study," *Journal of Elder Abuse and Neglect*, 2017, 29:1, pp. 15–42. True Link Financial (2015) estimates that 954,000 seniors are skipping meals as a result of financial losses from abuse.

2020 Writers' Cohort

Last year, the *Community Banking Connections* Advisory Board announced the creation of a Writers' Cohort. Supervision employees from across the Federal Reserve System were asked to submit a paper on one of two topics. From the submissions, 10 writers were selected to be part of the cohort. Their mission is to write feature articles to help readers better understand supervisory expectations, safety and soundness rules and regulations, and the role of supervisory guidance.

Cohort Chairs:

Ben Clem, Senior Examiner, Supervision, Regulation, and Credit, FRB Richmond

Jennifer Grier, Senior Examiner, Supervision, Regulation, and Credit, FRB Atlanta

Cohort Members:

Kerri Allen, Examiner, Examinations & Inspections, FRB Kansas City; **Robert Crepinsek**, Examiner, Supervision, Regulation, and Credit, FRB Boston; **Anthony Gonitzke**, Senior Examiner, Financial Institution Supervision and Credit, FRB San Francisco; **Jordan Jhamb**, Financial Analysis Associate, RCFI, FRB New York; **William Mark**, Lead Examiner, Supervision and Regulation, FRB Chicago; **Kalyn Neal**, Examiner/Supervisory Specialist, Examinations & Inspections, FRB Kansas City; **Alex Shelton**, Portfolio Central Point of Contact/Senior Examiner, Supervision, Regulation, and Credit, FRB Richmond; **Scott Zurborg**, Senior Large Bank Examiner, Supervision and Regulation, FRB Chicago

Improved Risk Identification Helps Tailor Examinations to Banks' Risk Levels

by Vadim Bondarenko, Senior Data Scientist, Federal Reserve Board of Governors; Chris Henderson, Assistant Vice President, Federal Reserve Bank of Philadelphia; and Matthew Nankivel, Managing Director, Federal Reserve Bank of Minneapolis

The Bank Exams Tailored to Risk (BETR) program is the Federal Reserve's new approach to tailoring supervision of community and regional banks.¹ The BETR program was adopted in June 2019 and is responsive to Congress's call to enhance tailoring of supervisory programs.² Although risk focusing is a long-standing practice for bank supervisors, BETR enhances this practice by taking a rigorous and structured approach to combining data analytics and examiner judgment to plan the scope of bank examinations.

The BETR program is structured around the most important risks faced by a bank (e.g., credit, liquidity, and earnings risks). For each risk dimension, the BETR program combines a rigorous data-driven approach to measuring a bank's risk, examination procedures appropriately tailored to the level of risk, and an examination staffing process for aligning supervisory resources to risk. The BETR program provides several benefits, including:

- improved risk identification and measurement processes that allow the Federal Reserve to apply more streamlined examination work programs to state member banks (SMBs) with lower risk profiles. This helps reduce the burden on banks with lower-risk activities by expending fewer hours on the examination; it also enhances the Federal Reserve's ability to target high-risk activities that need elevated supervisory attention at SMBs.
- standardized work programs in alignment with risk, which promote consistent examinations and the balanced treatments of SMBs.
- an improvement in ongoing risk monitoring between examinations. Specifically, BETR helps identify early signs

of increased risk-taking, both at individual SMBs and across the banking industry.

What aspects of supervision does BETR not include? BETR is an examination scoping tool, but it does not replace the examination process itself or contribute directly to supervisory ratings. In addition, BETR is not a substitute for supervisory judgment or a replacement for examiner discretion. Finally, although BETR seeks to identify banks with higher chances of adverse performance, it does not predict a bank's viability.

“ BETR is an examination scoping tool, but it does not replace the examination process itself or contribute directly to supervisory ratings. ”

This article builds on the information contained in SR letter 19-9, “Bank Exams Tailored to Risk (BETR).” It discusses the development of BETR's surveillance metrics, explains the process of tailoring examination procedures to risk, and presents aggregate risk classification results for small commercial banks.

BETR's Surveillance Metrics

Data analytics is an increasingly important component of bank supervision. To this end, BETR uses surveillance metrics that help identify and measure the risks faced by community and regional SMBs. Federal Reserve supervisory staff are directed to collect, analyze, evaluate, and act on risk information that is available from Call Reports, supervisory findings, and other information sources. The role of data analytics is to help select — from the large quantity of data available to supervisors — those data elements that, when optimally combined, provide the most forward-looking and reliable risk signals.

¹ The BETR program applies to community and regional state member banks and is detailed in Supervision and Regulation (SR) letter 19-9, available at www.federalreserve.gov/supervisionreg/srletters/sr1909.htm.

² See the Board of Governors' statement about the Economic Growth, Regulatory Relief, and Consumer Protection Act (EGRRCPA) at www.federalreserve.gov/newsevents/pressreleases/bcreg20180706b.htm.

In the BETR program, data analytics generates a set of risk indicators that result in a risk classification, or risk tier, of low, moderate, or high for each type of risk considered. Supervisory staff combine a variety of risk indicators into a single measure estimating the likelihood of an adverse performance outcome, such as a highly unfavorable financial trend, significant performance shortfall, severe loss, or supervisory rating downgrade, typically over a 12- to 24-month time frame, under unfavorable market conditions. A risk tier of high applies to activities that, under unfavorable market conditions, often lead to adverse outcomes. At the other end of the risk spectrum, for low-risk activities, the expected incidence of adverse outcomes is low, irrespective of market conditions.

Examiners can change the risk tier when they are aware of factors outside the BETR metrics, and there is a system in place to review all overrides. For example, an examiner might increase the risk tier because the bank is planning a significant strategy change or key management turnover. Examiners also have the ability to decrease the risk tier, such as when risk associated with an agricultural portfolio is partially mitigated by well-administered government guarantees.

Figure 1: Examples of Potential Credit Risk Indicators*

Credit Concentration

- Agricultural loans
- Commercial and industrial loans
- Commercial real estate loans
- Construction and land development loans
- Combined loan concentrations

Banking Strategy

- High loan growth indicator
- Noncore funding dependence

Loan Performance

- Loans 30–89 days past due
- Loans 90 or more days past due
- Net loan charge-offs

*The list of potential risk indicators shown here is for illustration purposes only. The specific risk indicators used and the manner of their combinations into risk tiers can change over time.

Risk tailoring can enhance bank supervision by integrating forward-looking risk metrics that allow examination procedures to be calibrated to the risk profile of an institution. Currently, the BETR program uses such surveillance metrics for the following examination areas: capital, credit, earnings, liquidity, interest rate risk, and investment securities. Figure 1 provides an example of the types of data elements that examiners have found useful in assessing credit risk. Some of the risk indicators pertain to current loan performance, while others reflect a bank's credit exposure or business strategy. A bank's current performance and its forward-looking risk posture can both play important roles in assessing risk and planning the scope of examination work.

The BETR model allows examination staff to assign probabilities to future adverse credit outcomes, which, in turn, helps direct more resources to institutions with higher risk activities. An example of a possible adverse credit outcome would be a bank that has a so-called Texas ratio in the worst 10 percent of all commercial banks in a given quarter. These metrics become more critical as the U.S. economy moves toward turning points in the cycle and the number of problem banks begins to rise or fall.³

The U.S. economy is in a record expansion following its previous trough in the second quarter of 2009. Participants in the financial press, regulatory briefings, and academic publications have noted an increasing number of potential banking risks. BETR's surveillance program produces forward-looking metrics that could help supervisory staff look beyond current conditions to identify and address risks that could be present or may be building.

Risk-Aligned Examination Work Programs

The primary goals of the BETR program are to create standardized, risk-aligned work programs for examiners to promote appropriate differentiation in the scope of work across risk tiers and to ensure a consistent supervisory program. The more accurately surveillance metrics are able to assess risk, the more appropriately examiners can differentiate examination work programs across risk tiers. In other words, more robust risk measurement enables greater reduction in examination scope and possible burden for banks with designated low-risk activities.

³ A basic Texas ratio is defined as the value of nonperforming loans plus other real estate owned divided by the sum of tangible equity capital and the allowance for loan and lease losses.

Table: Overview of Liquidity Risk Reviews

Risk Tier	Low	Moderate	High
Number of Procedures Required	7	19	44
Depth of Examiner Review	Examiners look at high-level liquidity risk management practices and review the bank's internal measurements to confirm that risk is low.	Examiners review the bank's internal measurements to confirm that risk is moderate. They assess the strength of liquidity risk management practices and verify that controls are adequate for the level of risk present, focusing on rate-sensitive funding sources and the bank's susceptibility to a liquidity stress event.	Examiners independently evaluate the level of risk, including reviewing reliance on wholesale funding sources, availability of asset-based liquidity, and stability of local deposits. Examiners review the adequacy of management's efforts to monitor and control the higher level of funding risk. This includes reviewing liquidity risk management and monitoring systems (e.g., funding reports) and performing a detailed review of the bank's limits, early warning indicators, and contingency funding plan.

The specific manner of risk tailoring of examination processes proceeds along two dimensions. First, low- or moderate-risk work programs are shorter and cover fewer topics than high-risk work programs. Second, examiners adjust the depth of review to reflect a bank's risk level. In practice, this means that for banks with high-risk activities, examiners apply the full extent of examination procedures and conduct additional work as necessary, including independent verification and transaction testing. At banks with activities classified as moderate risk, examiners apply a subset of examination procedures, with a focus on evaluating an SMB's key risk drivers, and limit independent verification and transaction testing to specific areas. Finally, when reviewing banks with low-risk activities, examiners apply a smaller subset of examination procedures, and transaction testing is reduced further.

As shown in the Table, the number of required examination procedures for liquidity risk aligns with the designated risk tier. Similar risk tailoring occurs for the other risk dimensions covered by the BETR program. As a result, banks with low-risk activities should experience shorter examinations, while banks engaged in higher-risk activities are subject to more intense supervisory focus.

Aggregate Risk-Tiering Results

As banks' strategies and actions result in evolving risk profiles, the BETR program's risk indicators capture such movements, which can lead to changes in risk tiers. Figure 2 shows that, for capital, credit, earnings, and liquidity, the share of small banks classified as high- or moderate-risk was notably greater at the start of the last recession than more recently, indicating a moderation in bank risk profiles over time.⁴

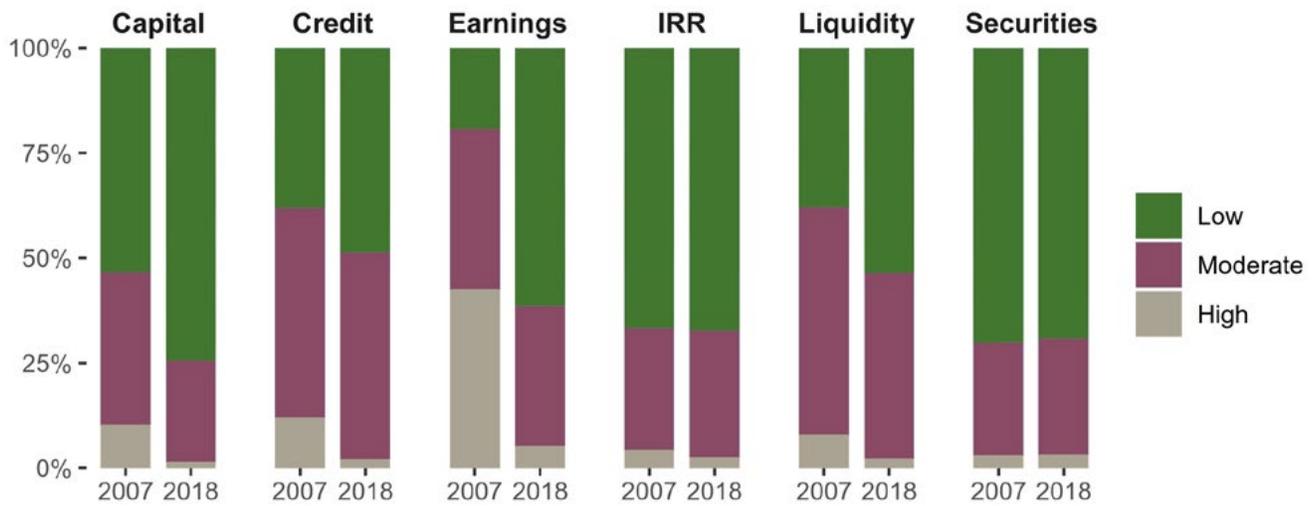
These risk-tier distribution results point to the relatively high degree of risk embedded in the banks before the recession, with small banks now generally better positioned to handle unfavorable market conditions.

The results for earnings risk in 2007 and 2018 illustrate some of the benefits of the BETR risk-tiering methodology by providing a more forward-looking view. A basic point-in-time indicator for bank earnings, the return on average assets (ROAA), was fairly strong in both periods, with a year-end median of about

⁴ The 2007 risk tiers presented in Figure 2 were created using historical data in current metrics; however, BETR's risk metrics were not available during the last recession.

Figure 2: Percent of Banks by BETR Risk Tier

All commercial banks under \$10 billion in total assets



Sources: Call Report, Federal Reserve calculations

“ The primary goals of the BETR program are to create standardized, risk-aligned work programs for examiners to promote appropriate differentiation in the scope of work across risk tiers and to ensure a consistent supervisory program. ”

1.1 percent for 2007 and 2018.⁵ However, there were more cases of high earnings risk in 2007, as captured by BETR and risk indicators such as high interest expense relative to peers and high noninterest expense compared with revenue.

The Future of the BETR Program

The BETR program’s risk classification and examination procedures are currently in use for capital, credit, earnings, liquidity, interest rate, and securities risks. The Federal Reserve is also developing risk metrics and examination procedures in the BETR program to address nonfinancial risks, such as those covered in Bank Secrecy Act/Anti-Money Laundering reviews. As the program continues to evolve, metrics and procedures for additional risk dimensions are in development and will be deployed as work is completed. The Federal Reserve is also committed to continuously reviewing metrics and procedures to ensure accuracy. This allows the Federal Reserve not only to continue to risk-tailor examinations but also to further improve examination processes. The BETR program puts the Federal Reserve in a stronger position to gauge the risks within a bank’s activities, align examination procedures with risk levels, and monitor risk between examinations. ■

⁵ This is calculated as the median ROAA for all commercial banks with less than \$10 billion in assets.

CECL Corner

How Bankers Can Prepare for Current Expected Credit Losses (CECL) Implementation

Although certain community banks adopted CECL in 2020, private and smaller reporting companies have until 2023 to apply CECL. Don't delay; start preparing today. CECL is scalable to an institution's size and complexity. It permits the use of various methods to estimate expected credit losses. Plus, community banks may choose to implement CECL without the use of costly or complex modeling techniques.

So, how can community banks prepare for CECL? If you have not done so already...

Familiarize: Review the new accounting standard (FASB ASU No. 2016-13 "Measurement of Credit Losses on Financial Instruments") and determine your implementation date. Identify data requirements and system changes needed to implement CECL. Once you have all the information, determine an implementation plan and timeline.

Talk about it: Hold discussions with your board of directors, industry peers, regulators, and external auditors (if applicable).

Don't reinvent the wheel: Review current allowance and credit risk management practices to identify existing processes that can be leveraged when applying CECL. Additionally, retain existing data used in the current allowance process and consider whether there is a need to capture additional data.

The CECL Resource Center

Do you know about the CECL Resource Center? This website, available at www.supervisionoutreach.org/cecl, is a "one-stop" resource for smaller financial institutions as they prepare for the changes associated with CECL. The Methodologies and Examples area (under the Methodology tab) of the CECL Resource Center also contains an Excel workbook with examples of the three methodologies presented in previous Ask the Regulators webinars:

- April 2019 Ask the Regulators webinar "Weighted-Average Remaining Maturity (WARM) Method." The presentation slides and a transcript of the remarks can be downloaded at www.supervisionoutreach.org/cecl/methodologies-and-examples.
- February 2018 Ask the Regulators webinar, "Practical Examples of How Smaller, Less Complex Community Banks Can Implement CECL." The presentation slides and a transcript of the remarks can be downloaded at www.webcaster4.com/Webcast/Page/583/24368.
- The Excel workbook with three methodologies from the webinars is available at www.supervisionoutreach.org/cecl/methodologies-and-examples.

Agencies Allow Three-Year Regulatory Capital Phase-In for New CECL Accounting Standard

On December 21, 2018, the federal bank regulatory agencies approved a final rule (capital rule) modifying their regulatory capital rules and providing an option to phase in over a period of three years the day-one regulatory capital effects of the updated accounting standard known as the CECL methodology. The capital rule phase-in is intended to address the concerns stated by some banks about the difficulty in capital planning due to the uncertainty about the economic environment at the time of CECL adoption. The regulatory agencies also committed to closely monitoring the effects of CECL on regulatory capital and lending practices.

To provide feedback or ask questions on CECL implementation, please reach out to your Reserve Bank liaison.

District	Liaison	Contact Email
Atlanta	Mark Wuethrich	mark.wuethrich@atl.frb.org
Atlanta	Vanessa Cameron	vanessa.cameron@atl.frb.org
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Chicago	Beth Ewing	elizabeth.ewing@chi.frb.org
Chicago	Yemisi Aremu	yemisi.aremu@chi.frb.org
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St. Louis	Larry Sherrer	larry.d.sherrer@stls.frb.org

Additional Resources

- American Institute of Certified Public Accountants, “Credit Loss Standard (CECL) Issues,” available at www.aicpa.org/interestareas/frc/industryinsights/credit-loss-standard-issues.html.
- “CECL Readiness Tool,” available at www.csbs.org/cecl-readiness-tool.
- Financial Accounting Standards Board, “Q&A: Developing an Estimate of Expected Credit Losses on Financial Assets,”

Topic 326, No. 2, available at www.fasb.org/jsp/FASB/Document_C/DocumentPage&cid=1176172970152.

- Financial Accounting Standards Board, “Q&A: Whether the Weighted-Average Remaining Maturity Method Is an Acceptable Method to Estimate Expected Credit Losses,” Topic 326, No. 1, available at www.fasb.org/jsp/FASB/Document_C/DocumentPage&cid=1176171932989.

Recap of the Third Annual Fintech Conference

by Chantel Gerardo, Exam Report Review Analyst III, Supervision, Regulation, and Credit, Federal Reserve Bank of Philadelphia

The Federal Reserve Bank of Philadelphia hosted the Third Annual Fintech Conference on November 14–15, 2019, in partnership with outside experts from several well-known organizations, including the Wharton School of the University of Pennsylvania, the Bank Policy Institute, the Brookings Institution, the University of Cambridge, and others. Philadelphia Reserve Bank President Pat Harker kicked off the conference with a reminder to all that the underlying message of fintech has stayed the same. “In the grand scheme of technology and advancement, fintech is no different – what’s different now is how fast it’s happening,” remarked Harker, prior to introducing Chicago Reserve Bank President Charles Evans. Similarly, President Evans used tales of the early days and delays of check clearing to stress the need for innovative, resilient real-time payments, a need that FedNow could eventually support.

The representatives from Square Financial Services, Google Cloud, Harvard Law School, and the Peterson Institute for International Economics discussed the cloud, big data, and artificial intelligence. From Square Financial Services giving small business owners access to the financial system to Google Cloud hosting 25 percent of the global internet traffic, fintech

has created opportunities for new entrants into the market. Although fintech is fairly new to the United States, the “fintech revolution” has filled a financial services market gap in China that began in the early 90s. Now, cash is rare in major Chinese cities, and fintech companies have become financial giants. With the growth of fintech and the cloud in the U.S. and abroad, panelists encouraged regulators to streamline due diligence and risk assessment requirements that financial institutions are subject to before and after cloud migration, as well as to clarify cross-border regulations for cloud services.

Leaders from Upstart, Amazon Web Services, Avant, Affirm, and Blend explored the current and future state of fintech partnerships with a representative from TD Bank. Both sides stressed the importance of due diligence before entering into a partnership. While acknowledging some process improvement related to algorithms, providers discussed the potential of artificial intelligence and machine learning to continue to advance process automation and enhance customer experiences. Overall, panelists want to continue the conversation with regulators in determining sound practices when creating banking and fintech partnerships. ■

PRESS RELEASES

Federal bank regulatory agencies find that the share and amount of loan commitments with the lowest supervisory ratings rose slightly between 2018 and 2019, according to the Shared National Credit Program Review. The press release, which was issued on January 31, 2020, is available at www.federalreserve.gov/newsevents/pressreleases/bcreg20200131a.htm.

The Federal Reserve finalized a rule to simplify and increase the transparency of the Board's rules for determining control of a banking organization. The final rule is largely consistent with the proposal, establishing a comprehensive and public framework to determine when a company controls a bank or a bank controls a company. The press release, which was issued on January 30, 2020, is available at www.federalreserve.gov/newsevents/pressreleases/bcreg20200130a.htm.

Five federal financial regulatory agencies invited public comment on a proposal to modify regulations implementing the Volcker rule's general prohibition on banking entities investing in or sponsoring hedge funds or private equity funds — known as “covered funds.” Since the regulations implementing the Volcker rule were finalized in 2013, the rule has created compliance uncertainty and imposed limits on certain banking services and activities that it was not intended to restrict. To address these concerns, the agencies issued a proposal to simplify the requirements for the proprietary trading restrictions in November 2019. The press release, which was issued on January 30, 2020, is available at www.federalreserve.gov/newsevents/pressreleases/bcreg20200130b.htm.

Michelle W. Bowman was sworn in for a second term as a member of the Board of Governors of the Federal Reserve System. The press release, which was issued on January 30, 2020, is available at www.federalreserve.gov/newsevents/pressreleases/other20200130a.htm.

The Federal Reserve Board announced the members of its Community Depository Institutions Advisory Council for 2020. CDIAC advises the Board on the economy, lending conditions, and other issues of interest to community depository institutions. The press release, which was issued on January 14, 2020, is available at www.federalreserve.gov/newsevents/pressreleases/other20200114a.htm.

The FDIC and Federal Reserve extended the deadline to request information on the Uniform Financial Institutions Rating System, also known as CAMELS. The agencies extended the comment period until February 28, 2020, to allow interested people more time to analyze the issues and prepare their comments, which were originally due by December 30, 2019. The press release, which was issued on December 20, 2019, is available at www.federalreserve.gov/newsevents/pressreleases/bcreg20191220a.htm.

The Federal Reserve Board announced a series of “fintech innovation office hours” across the country to meet with banks and companies engaged in emerging financial technologies. The sessions will serve as a resource for banks and fintech firms to meet one-on-one with Federal Reserve staff members with relevant expertise to discuss fintech developments and ask questions. The press release, which was issued on December 17, 2019, is available at www.federalreserve.gov/newsevents/pressreleases/other20191217a.htm.

Four federal agencies in conjunction with the state bank regulators issued a statement clarifying the legal status of hemp growth and production and the relevant requirements under the Bank Secrecy Act for banks providing services to hemp-related businesses. The statement emphasizes that banks are no longer required to file suspicious activity reports for customers solely because they are engaged in the growth or cultivation of hemp in accordance with applicable laws and regulations. The press release, which was issued on December 3, 2019, is available at www.federalreserve.gov/newsevents/pressreleases/bcreg20191203a.htm.

Five federal financial regulatory agencies issued a joint statement on the use of alternative data in underwriting by banks, credit unions, and nonbank financial firms. The press release, which was issued on December 3, 2019, is available at www.federalreserve.gov/newsevents/pressreleases/bcreg20191203b.htm.

Federal bank regulatory agencies issued a final rule on the treatment of high-volatility commercial real estate. The press release, which was issued on November 19, 2019, is available at www.federalreserve.gov/newsevents/pressreleases/bcreg20191119b.htm.

Federal bank regulatory agencies issued a final rule to simplify the capital calculation for community banks (community bank leverage ratio). The press release, which was issued on October 29, 2019, is available at www.federalreserve.gov/newsevents/pressreleases/bcreg20191029a.htm.

Four federal financial regulatory agencies sought comment on a proposed interagency policy statement on allowances for credit losses and proposed interagency guidance on credit risk review systems. The press release, which was issued on October 17, 2019, is available at www.federalreserve.gov/newsevents/pressreleases/bcreg20191017a.htm.

Federal bank regulatory agencies issued a final rule to update rules restricting the ability of a director or other management official to serve at more than one depository institution, known as management interlock rules. The press release, which was issued on October 2, 2019, is available at www.federalreserve.gov/newsevents/pressreleases/bcreg20191002a.htm.

SPEECHES

Vice Chair of Supervision Randal K. Quarles gave a speech at the American Bar Association Banking Law Committee Meeting 2020 in Washington, D.C., on January 17, 2020. His speech, titled “Spontaneity and Order: Transparency, Accountability, and Fairness in Bank Supervision,” is available at www.federalreserve.gov/newsevents/speech/quarles20200117a.htm.

Governor Michelle W. Bowman gave a speech at the 2020 Economic Forecast Breakfast, Home Builders Association of Greater Kansas City in Kansas City, MO, on January 16, 2020. Her speech, titled “The Outlook for Housing,” is available at www.federalreserve.gov/newsevents/speech/bowman20200116a.htm.

Governor Lael Brainard gave a speech at the Urban Institute in Washington, D.C., on January 8, 2020. Her speech, titled “Strengthening the Community Reinvestment Act by Staying True to Its Core Purpose,” is available at www.federalreserve.gov/newsevents/speech/brainard20200108a.htm.

Governor Michelle W. Bowman gave closing remarks at the Gender and Career Progression conference at the European Central Bank in Frankfurt, Germany, on October 21, 2019. Her remarks are available at www.federalreserve.gov/newsevents/speech/bowman20191021a.htm.

Governor Michelle W. Bowman gave introductory remarks at Monetary Policy’s Impact on Workers and Their Communities, a *Fed Listens* event, sponsored by the Federal Reserve Bank of Chicago in Chicago on October 17, 2019. Her remarks are available at www.federalreserve.gov/newsevents/speech/bowman20191017a.htm.

Governor Lael Brainard gave a speech at The Future of Money in the Digital Age, sponsored by the Peterson Institute for International Economics and Princeton University’s Bendheim Center for Finance in Washington, D.C., on October 16, 2019. Her speech, titled “Digital Currencies, Stablecoins, and the Evolving Payments Landscape,” is available at www.federalreserve.gov/newsevents/speech/brainard20191016a.htm.

Governor Michelle W. Bowman gave a speech at the 2019 Community Banking Research and Policy Conference, “Community Banking in the 21st Century,” sponsored by the Federal Reserve System, the Conference of State Bank Supervisors, and the Federal Deposit Insurance Corporation in St. Louis on October 1, 2019. Her speech, titled “Advancing Our Understanding of Community Banking,” is available at www.federalreserve.gov/newsevents/speech/bowman20191001a.htm.

TESTIMONIES

Vice Chair of Supervision Randal K. Quarles testified before Congress in December 2019 in connection with the release of the Federal Reserve Supervision and Regulation Report (November 2019). The report summarizes banking conditions and the Federal Reserve’s supervisory and regulatory activities, in conjunction with semiannual testimony before Congress by the vice chair for Supervision. The testimony and report are available at www.federalreserve.gov/publications/supervision-and-regulation-report.htm.

Arthur Lindo, deputy director, Division of Supervision and Regulation, testified on minority depository institutions before the House Financial Services Subcommittee on Consumer Protection and Financial Institutions, U.S. House of Representatives, in Washington, D.C., on November 20, 2019. The testimony is available at www.federalreserve.gov/newsevents/testimony/lindo20191120a.htm.

Supervision & Regulation (SR) & Consumer Affairs (CA) Letters

The following SR and CA letters that have been published since the last issue (and are listed by most current) apply to community banking organizations. Letters that contain confidential supervisory information are not included. All SR letters are available by year at www.federalreserve.gov/supervisionreg/srletters/srletters.htm and by topic at www.federalreserve.gov/supervisionreg/topics/topics.htm. A complete list of CA letters can be found at www.federalreserve.gov/supervisionreg/caletters/caletters.htm.

- SR Letter 20-3/** “Interagency Statement on Pandemic Planning”
CA Letter 20-2
- SR Letter 19-16** “Status of Certain Investment Funds and Their Portfolio Investments for Purposes of Regulation O and Reporting Requirement Under Part 363 of FDIC Regulations”
- SR Letter 19-15** “Revised Examination Guidelines for Representative Offices of Foreign Banks”
- SR Letter 19-14** “Statement on Providing Financial Services to Customers Engaged in Hemp-Related Businesses”
- SR Letter 19-13** “*FFIEC Information Technology Examination Handbook*”
- SR Letter 19-12** “Statement Regarding Insurance Policies for Directors and Officers”
- CA Letter 19-12** “Consumer Compliance Supervision Bulletin”
- SR Letter 19-11** “Joint Statement on Risk-Focused Bank Secrecy Act/Anti-Money Laundering Supervision”
- CA Letter 19-11** “Interagency Statement on the Use of Alternative Data in Credit Underwriting”
- SR Letter 19-10** “Final Rule Revising the Board’s Delegation Rules for Certain Types of Applications, Notices, and Requests”
- CA Letter 19-10** “Revised Interagency Examination Procedures for the Flood Disaster Protection Act”
- CA Letter 19-9** “Final Rule Revising the Board’s Delegation Rules for Certain Types of Applications, Notices, and Requests”
- CA Letter 19-8** “Interagency Examination Procedures for Regulation X”
- CA Letter 19-7** “Revised Interagency Examination Procedures for Regulation Z”
- CA Letter 19-6** “Revised Interagency Examination Procedures for Regulation E”
- CA Letter 19-5** “Revised Home Mortgage Disclosure Act Examination Procedures”
- CA Letter 19-4** “Revised ‘A Guide to HMDA Reporting: Getting It Right!’”

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