September 22, 2022 Minority Depository Institution Advisory Committee Minutes

The Minority Depository Institution Advisory Committee (MDIAC) convened its hybrid (in-person and virtual) meeting at 10:00 Eastern Daylight Time on September 22, 2022. The meeting was open to the public, as required under Public Law 92-463.The committee members, Office of the Comptroller of the Currency (the OCC), management and staff attended largely from OCC Headquarters in Washington, DC. External panelists, public observers and some OCC management and staff not in OCC Headquarters attended virtually from around the United States.

Committee Members Present:
Natalie Abatemarco, Managing Director, Citi Community Investing and Development, New York, NY; John J. Hou, Chief Executive Officer and President, Asian Pacific National Bank, San Gabriel, CA (attended virtually); Dr. Jody Lee, Chairman of the Board, Southwestern National Bank, Houston, TX; Beverly Meek, First Vice President, CRA Director, Flagstar Bank, FSB, Troy MI; Thomas Ogaard, President and Chief Executive Officer, Native American Bank, National Association, Denver, CO; Joe Quiroga, President, Texas National Bank, Mercedes, TX; Kelly Skalicky, President and Chief Executive Officer, Stearns Bank National Association, St. Cloud, MN

Management and Staff from the OCC Present:
Michael Hsu, Acting Comptroller of the Currency, Washington, DC; Jorge Aguilar, Counsel, Washington, DC; Jason Almonte, Special Counsel, Washington, DC; Charlotte Bahin, Senior Advisor for Thrift Supervision, Washington, DC; David Black, Community Development Expert, Compliance and Community Affairs, Washington, DC; Karen Boehler, Deputy Comptroller, Western District, Denver, CO; Joyce Cofield, Executive Director for Workforce Diversity and Inclusion, Washington, DC; Beverly Cole, Acting Senior Deputy Comptroller for Midsize and Community Bank Supervision, Washington, DC; Greg Coleman, Senior Deputy Comptroller for Large Bank Supervision, Washington, DC; Joel Denkert, Deputy Comptroller, Midsize Bank Supervision, Chicago, IL; Lissette Flores, Community Relations and Minority Affairs Specialist, Washington, DC; Grovetta Gardineer, Senior Deputy Comptroller for Bank Supervision Policy, Washington, DC; Larry Hattix, Senior Deputy Comptroller for Enterprise Governance and Ombudsman, Washington, DC; Brian James, Deputy Comptroller, Central District, Chicago, IL; Andre King, Assistant Deputy Comptroller, Chicago, IL; Beth Knickerbocker, Chief Innovation Officer, Washington, DC; Ernie Knott, National Bank Examiner (Financial Analysis), Northeastern District, New York, NY; Carrie Moore, Director for Congressional Liaison, Washington, DC; Andrew Moss, Director for Minority Outreach, Washington, DC; Donna Murphy, Deputy Comptroller for Compliance Risk Policy, Washington, DC; Yoolin Na, Bank Examiner, Director for District Licensing, Washington, DC; Linda Nichols, National Bank Examiner, Washington, DC; Erica Onsager, Counsel, New York, NY; Lauren Oppenheimer, Senior Deputy Comptroller and Chief of Staff, Washington, DC; Ancris Ramdhanie, Special Counsel, New York, NY; Johnny Stanley, Acting Deputy Comptroller, Northeastern District, New York, NY; Jasmine J. Talton, Counsel, Southern District Office, Dallas, TX; Joyce Trinidad,

National Bank Examiner (Large Banks), New York, NY; Barry Wides, Deputy Comptroller for Community Affairs, Washington, DC

Public Observers:
Diana Banks-Thompson, American Bankers Association, Washington, DC; Michael Batts, Jr., Public Observer; Michael Bailey, Senior Vice President, Chief Compliance Officer, American First National Bank, Houston, TX; Kim Baugh, CPA, Compliance Officer, Banc Central, San Antonio, TX; Sabrina Bergen, Senior Vice President, Office of Strategic Engagement, American Bankers Association, Washington, DC; Stacy Caswell, Operations Compliance Program Manager & CRA Officer, American Savings Bank, Honolulu, HI; Charles Cooper, Excelsior Fellow Attorney, New York State Department of Financial Services, New York, NY; David Ehrich, Executive Director, Alliance for Innovative Regulation, Washington, DC; Sonja J. Ellis, FDIC, Office of Minority and Community Development Banking, Washington, DC; Darlene Goins, EVP, Head of Banking Inclusion Initiative, Wells Fargo, San Francisco, CA; Ed Gutierrez, Southside Bank, Houston, TX; Alexis Harris, Public Observer; Pamela Keeler, First National Bank of Alaska, Anchorage, AL; Anika Parker, Corporate Specialist, Ohio Department of Commerce, Division of Financial Institutions, Columbus, OH; Natasha Pope, First National Bank of Alaska, Anchorage, AL; Liela Raglin, Southside Bank, Houston, TX; Sara Reid, Public Policy Liaison, Financial Inclusion, FIS Global, Washington, DC; Betty J. Rudolph, Director, Office of Minority and Community Development Banking, FDIC, Washington, DC; Tamilee Smull, Compliance Officer, Canyon Community Bank, N.A. Tucson, AZ; Thiru Vignarajah, CEO, Capital Plus Financial, Washington, DC; Laurie Vignaud, Public Observer; Jeff Weaver, President and CEO, American Bank, Grapevine, TX; Alice Yang, Middle Market/Commercial Lending Group Manager, Southside Bank, Houston, TX; Sharon Zimmerman, Vice President, MDI & Regulatory Affairs, Woodforest National Bank, The Woodlands, TX

Call to Order and Welcome
The event producer, Tegan, welcomed and thanked everyone for joining the MDIAC meeting. She then provided technical instructions for virtual attendees to open the WebEx chat panel. Further, it was noted that all audio connections were muted and informed participants they could submit written questions throughout the presentation. These questions will be addressed during the Q&A. Persons requiring technical assistance, were instructed to send a chat to the event producer. The meeting was then turned over to Beverly Cole, Acting Senior Deputy Comptroller for Midsize and Community Bank Supervision and Designated Federal Officer (DFO).

Beverly Cole opened the meeting and thanked those for attending. Andre King was introduced to the group as the individual that would succeed Beverly Cole as the Designated Federal Officer in 2023. Andre is a 19 year OCC employee and currently the Assistant Deputy Comptroller (ADC) in the Downers Grove Field Office in the Chicago, Illinois area. Beverly indicated she would continue to attend these meetings to ensure a smooth transition. Andre indicated it was an honor to attend and that he was humbled and excited for the opportunity.

State of MDIs (Financial Analysis)

The meeting was turned over to Ernie Knott, Financial Analyst to provide an update on the state of MDIs. The information presented is as of June 30, 2022 unless otherwise indicated. The analysis primarily assesses the population of bank regulated by the OCC unless noted otherwise. Ernie explained that his presentation would start with portfolio demographics - cover charter trends, charter type and size and MDI group. He would address supervisory information (data gathered from examinations) which is based on OCC examiners' evaluation of banks and includes ratings, risk assessments, Matters Requiring Attention (MRAs) and violations of law. The third part of the presentation covered (financial information) which is sourced mainly from Reports of Condition and Reports of Income (Call Reports). Each safety and soundness area, including interest rates would be addressed. Ernie encouraged participants to ask questions throughout the presentation.

Ernie's PowerPoint presentation is provided as an attachment to these minutes. Most of his commentary is included in the minutes so the reader does not have to conduct their own analysis of the data provided.

Slide 25 provides a conclusionary recap of the presentation and is recapped here. MDIs are increasing as a share of total OCC charters. MDIs represent 54 or 5.2% of OCC bank charters and $34.4 billion or 4.0% of community bank assets as of June 30, 2022. MDI composite ratings improved this year; 83% of MDIs are rated composite 1 or 2. Capital is satisfactory. MDI capital levels are sharply higher this year and remain above peer. The MDI leverage ratio increased to 12.21 percent and more MDIs are rated 1 for capital. Asset quality is satisfactory. Total past due loans plus OREO remain low and declining at 1.68 percent. Loan growth is tepid but much higher after adjusting for PPP loans. The ALLL is adequate and directionally consistent with the uptick in classified assets. Earnings are adequate. ROAA decreased in 2022 due to a contraction in noninterest income and much higher noninterest expense. Liquidity is abundant. While MDIs remain flush with liquidity, the growth rate in deposits continues to slow. Ninety-six percent of MDIs are rated 1 or 2 for liquidity. Sensitivity to market risk remains adequately controlled. MDIs are holding higher levels of nonmaturity deposits relative to long-term assets making them less vulnerable to rising interest rates. Investment portfolio depreciation increased sharply this year.

Slide 3 reflects OCC supervises a diverse group of 1,162 institutions or 1,043 charters (first four columns in this chart). The MDIs are from columns one and three.

Slide 4 at the top shows that MDIs represent 54 or 5.2% of OCC bank charters which is a increase from 3.2%.

Slide 5 at the bottom shows that MDIs represent about $34.4 billion or about 4% of community bank total assets. This chart does not include the trust, midsize or large banks, and since no MDIs are from those groups, it's only fair to compare MDIs to other community banks. A committee member wanted to know that since MDIs comprised

about 4% of community banks what the percentage would be compared to all banks. Ernie confirmed the percentage would be really low. He stated that OCC regulates four mega banks (JP Morgan Chase, Bank of America, Wells Fargo and Citibank). Those four charters alone represent about $9.3 trillion or 61% of OCC regulated institutions. Ernie again confirmed information for trust, midsize, or large banks (including the mega banks) were not included in the data since no bank in that population is an MDI.

Slide 5 is a new slide and reflects state and national charters. In 2022, the OCC departure rate slowed to about 3%, which is low for the industry. The industry is about 3% to 5% over the last decade and the other factor that's putting upward pressure on the consolidation rate is the lower volume of de novo banks. As late as 1997, OCC chartered a hundred banks in that year, the environment has changed, but the top chart makes it very clear why MDIs are increasing as a share of total charters. The net number of MDIs has not changed since 2013. Non-MDI charters decreased by 39% due mainly to mergers and acquisitions.

MDIs gained as a share of total charters from 3.2 to 5.2%. On the bottom, this is a deeper dive into the MDIs. That's a breakout for each group and there's been one change in 2022. The women owned population increased by one - Agility Bank in Houston, Texas, OCC's newest women owned MDI was chartered in April of 2022.

A committee member asked for clarification as the information reflected a slow net decrease in charters and wanted to know the breakout by new banks versus merged banks. Ernie stated that most decreases were due to true consolidation where two existing banks merge into one. And, that the number of new charters could be either a de novo or a conversion from other regulators – about 15 over the ten year period. There were questions about the number for charters at other regulators. Ernie did not have those comparisons readily available – but indicated there are more new charters from other regulators. Ernie pointed out that OCC supervises about 65% of the banking system. Beverly stated that OCC is happy to be a regulator that regulates institutions of all sizes as it provides an opportunity for a broader perspective.

Another committee member indicated that sometimes examiners that regulate both small and large institutions may have difficulty tailoring examination comments for smaller institutions. Beverly indicated she needs to be made aware of those instances especially in her new role as the Senior Deputy Comptroller for Midsize and Community Bank Supervision. The management team in the institution's geography needs to be made aware also as our examination staff should scale our examination comments and expectations to the risk the institution is taking. The commentor also indicated the experience and perspective of the examiner also is a factor.

A committee member stated that several bankers may convert out of the national banking system due to fear of OCC's potential supervisory reaction as bankers anticipate a downturn in the economy. Some indicated they felt there was a disconnect for small bank versus large bank expectations. Another indicated as their bank's size grew they appreciated the insights of constructive next steps which are not mandated

by the OCC but that the banker needs to think about. Andre King assured the group that there is an experienced and seasoned team behind junior examiners that reviews examination findings for accuracy and support. He also stated he hoped that as the pandemic subsides OCC examiners have an opportunity to re-establish and build in-person relationships. Ernie stated even though OCC regulates large banks, the bulk of OCC resources are spent in community banks, and that bankers have a communication line to OCC management. The reduction in assessments is evidence OCC management is listening. A committee member stated it is important for OCC management to visit bankers and engage in good conversations.

Another committee member stated an appreciation for consistency in the regulatory process and knowing the regulator has history and knowledge, institutional knowledge about your individual institution and its strength and nuances is more important in the MDI space and smaller bank space where the business models and challenges and opportunities are unique.

The top of Slide 6 summarizes last column from Slide 5. Most MDIs or 39% of MDIs are Asian or Pacific Islander American and the bottom reflects the share of MDIs by OCC district, which will soon be a region and most MDIs or 50% are in the southern district.

Slide 7 shows the 54 OCC supervised MDIs are in 23 states and most of those are in Texas and California.

Slide 8 shows asset size and age. Most MDIs are smaller in size than the average community bank and have been operating for fewer years.

Slide 9 is a summary of the MDI peer group -started with $31.4 million, the smallest MDI up to $5.4 billion the largest. Again, mutual savings associations, trust banks are excluded from the peer. The average median size of the OCC MDI population is $293 million versus $456 million for those supervised by other regulators.

Slide 10 is the first slide reflecting supervisory information. The overall condition of MDIs is satisfactory and improving. The share of MDIs with a composite one or two rating increased to 83% this year and the proportion of one rated MDIs continues to increase. When the current distribution of MDIs is compared to 2019, the analysis shows the overall condition of MDIs is better now than pre-pandemic. The bottom of the slide reflects specialty ratings. They are satisfactory and no MDI is rated worse than four for any specialty area. Only four MDIs have trust powers. None are rated worse than two and no MDI is rated less than satisfactory for CRA.

Slide 11 shows the top three risks for the MDIs are credit, strategic and operational. We are in a period of Fed tightening and this has increased downside risk to the economic growth. Credit remains moderate, but areas of weakness and potential longer term implications resulting from the pandemic exist. The rising rate environment is putting financial stress on some of the businesses and individuals that may already be struggling. Strategic risks are associated with the bank's ability to adapt to the changing

industry and remain profitable. Operational risk is elevated as banks respond to an increasingly complex operating environment and more global cyber risks. The bottom of the slide reflects the supervisory cycle. Qualifying banks with less than $3 billion in total assets are eligible for the 18-month exam cycle if the bank has a one or two composite management rating, is well capitalized and is not subject to a formal enforcement action. Seventy-four percent of MDIs are on an 18-month cycle.

Slide 12 shows MRA volume which increased 9% over the prior year. Most of the MRAs are for Bank Information Technology (BIT) and Bank Secrecy Act/Anti-Money Laundering (BSA/AML) which is not a surprise as these are areas of examination focus. MRAs decreased the most for enterprise governance. The violation of law volume is down 50% for the same period. The top three violations are for real estate lending and appraisals, call reports and loans in areas having flood hazards.

Slide 13 starts the financial trends portion of the presentation. The MDI leverage ratio increased 121 basis points to 12.21%. It is much higher than the community bank peer. The leverage ratios were much higher in 2020 and 2021 due to the rapid asset growth from the pandemic related to deposits entering the banking system. This lowered the capital ratios by creating a larger denominator. Now MDI leverage ratios are higher despite the larger balance sheets that remain from the pandemic.

MDIs have higher total capital ratios than community bank peer. That ratio is up 80 basis points this year, and 17 or 31% of the MDIs have opted into the community bank leverage ratio (CBLR) framework. Ernie reported he developed a nine page MIS package which is an abridged version of this presentation. The management teams of MDIs might find it helpful as it contains the specific MDI's portfolio demographics, supervisory information, and a dashboard of key ratios. It would include the MDI's peer group and the line for the individual MDI. A banker could compare their bank to other community banks and MDIs. There was a discussion between Ernie and a committee member regarding the impact of stimulus funding where consumers saved the monies, the PPP funds, and the higher savings rate currently at about 5% but was about 15% during that time.

There were comments from committee members that PPP worked as intended and was good for MDIs. It was stated that MDIs completed more PPP lending relative to their size than larger institutions. There was conversation on whether MDIs could play a similar role during times of disaster by becoming designated disaster lenders. Another committee member reported on the challenges of implementing PPP manually during the pandemic with limited staff. Others reported hiring interns to assist with the workload and some reported acquiring new customers. Overall members thought MDIs proved they were in touch with the communities that are most heavily impacted by any economic disaster.

Slide 14 is the last capital slide and reflects 85% of MDIs are rated one or two for capital. More MDIs are rated one this year. If an MDI is well capitalized and opted into the CBLR framework, then maintenance of the 9% leverage capital is required.. Further

those that fall below the 9% leverage capital ratio will have a two quarter grace period to comply as long as the leverage capital ratio remains above 8%. Those that did not opt-in and are not under a formal enforcement action are evaluated by the capital rules in effect since 2015. Those four thresholds include: 5% for leverage, 8% for tier one, 10% for total, and the common equity tier one is 6.5%. As of June 30, 93% of MDIs are well capitalized. The MDIs with formal enforcement actions require higher minimums, and are adequately capitalized for that reason.

Slide 15 addresses earnings. The number of MDIs with one or two rated earnings improved to 80%. Looking at the top, the number of MDIs rated one or two improved to 80% for earnings.

Slide 16 shows ROA is lower this year. The median ROA decreased nine basis points. It is now above community bank tier. Also if you stratify the ROA by asset size, you're going to find the larger the bank generally, the better the ROA.

Slide 17 looks at the weighted average for ROA and slide 16 looks at the median. This slide merges all MDIs together as if they were one institution. And unlike the median, Slide17 gives more weight to the larger banks. The top left of the slide reflects the weighted average decreased due to the contraction in the non-interest income... and a 19%, a very large jump in the overhead or non-interest expense. Due to the rising rate environment, the gains on loan sales which was driving the decline in this category, dropped by 66% this year. And the drop for the loan sales of $44 million was three times the drop in the entire category. Despite that sharp decline in the gain on loan sales, that category remains the largest contributor to the MDI income at 17%, and deposit service charges is second at 15%. The bottom left of this slide is a summary of the top slide, and the top right is a new slide. This is an easy way to look at the changes in the ROA components. This chart divides the income numbers by average assets. You see the color coding. If you add up all the red, which is 46 minus the 15, you can see how the decrease in the 31 basis points is calculated. On the bottom right, non-interest expense increased a lot. Increases are seen across the board in all components, personnel, occupancy, and other operating expenses. And the biggest expense within other operating expenses is the 27% increase in IT expenses and consulting and advisory expenses increased 22%. The tight labor market made it more difficult for smaller banks versus banks in general to attract and retain talent. Banks pay more to attract and retain talent.

Slide 18 covers the interest margin. It rebounded, from last quarter low. The top of the slide shows the relatively low contribution of the income to total revenue, or the blue versus the orange. Operating revenue fell about six basis points since 2020. The compression appears to have bottomed out last quarter. Again, this was due to the rise in the federal funds rate.A quick look back to 2020, the Federal Reserve dropped the federal funds rate 75 basis points to combat Covid-19 at the time. Since then, all the deposits were flowing into the banking system, less loan demand. That money was flowing into the interest-bearing bank balances and securities, and were earning a lot

less than loans. The end result, was a numerator, the net interest income growing slower than the denominator, which created the compression. During that period, asset yields were falling faster than the cost of funds, which is the opposite of what is happening now; asset yields are increasing and many banks are reluctant to raise deposit rates or tend to raise them at a slower pace. Generally during these periods of compression, the MDIs and small banks are more adversely impacted since 86% of their income comes from the margin. This underscores the importance of growing the income, which MDIs did during the pandemic. This also leads to more industry consolidation. During these periods there's more mergers, especially for banks that experience the most compression. And there is a lot of cost cutting as well.

Slide 19 starts are discussion on asset quality. In general, asset quality ratings remain satisfactory and improved a little in 2022. 87% of MDIs have one or two rated asset quality. Past due loans and OREO reflect nonperforming assets declined to 1.68%. Some loans (CARES Act modifications) with a small balance also declined 98%. A committee member indicated that a rising rate environment does place stress on credit.

Slide 20 reflects the classified assets information banks provided to the OCC on a quarterly basis. With 80% of the banks reporting, a slight uptick in classified assets is noted, reflecting a little more stress at 12.09%. The allowance also increased and is directionally consistent with that slight uptick in classified assets. There was a very brief acknowledgement that most MDIs and community banks will implement Current Expected Credit Losses (CECL) on January 1, 2023. Bankers can expect examiners to ask about bankers' status with CECL implementation.

Slide 21 reflects loan growth. After adjusting for the PPP loans, the annual MDI loan growth was 4.89%. The largest loan category was in Commercial Real Estate loans. Loan growth in MDIs was greatest in the consumer loans, non-farm construction and development and multifamily loans. The large drop in the Commercial and Industrial loans was due to the PPP loans made about a year ago.

Slide 22 addresses liquidity and shows liquidity ratings remain strong with 96% of MDIs being rated one or two for this component. Many MDIs are flush with liquidity now. But the deposit growth rate – year over year – is declining. A high level of extra savings from the pandemic and the banking system remain but the U.S. personal savings rate is down from a year ago.

Slide 23 shows the on hand liquidity ratio is higher for MDIs this year and is well above the pre-pandemic levels. Because of the sharp rise in deposits and on hand liquidity, MDIs are relying less on wholesale funding sources.

Slide 24 on sensitivity ratings. The sensitivity ratings remain satisfactory. 92% of MDIs are rated one or two. MDIs have higher levels on non-maturity deposits, and that should

make them less vulnerable to increases in rates. The committee's attention to the big drop in the investment portfolio values. Depreciation increased substantially due to the federal reserve raising rates and their announcement to begin quantitative tightening.

Slide 25 provides a conclusionary recap of the presentation. MDIs are increasing as a share of total OCC charters. MDIs represent 54 or 5.2% of OCC bank charters and $34.4 billion or 4.0% of community bank assets as of June 30, 2022. MDI composite ratings improved this year; 83% of MDIs are rated composite 1 or 2. Capital is satisfactory. MDI capital levels are sharply higher this year and remain above peer. The MDI leverage ratio increased to 12.21 percent and more MDIs are rated 1 for capital. Asset quality is satisfactory. Total past due loans plus OREO remain low and declining at 1.68 percent. Loan growth is tepid but much higher after adjusting for PPP loans. The ALLL is adequate and directionally consistent with the uptick in classified assets. Earnings are adequate. ROAA decreased in 2022 due to a contraction in noninterest income and much higher noninterest expense. Liquidity is abundant. While MDIs remain flush with liquidity, the growth rate in deposits continues to slow. Ninety-six percent of MDIs are rated 1 or 2 for liquidity. Sensitivity to market risk remains adequately controlled. MDIs are holding higher levels of nonmaturity deposits relative to long-term assets making them less vulnerable to rising interest rates. Investment portfolio depreciation increased sharply this year.

Several committee members thanked Ernie for his work – especially on the reports tailored for their specific institution. Ernie welcomed their feedback especially feedback he could use to improve the reporting. He agreed to drill down on the 15 banks and determine what groups they represent and the correlation if any between minority areas being served adequately by other banks.

Innovation Update

Next Chief Innovation Officer Beth Knickerbocker addressed the committee. Beth indicated she was excited to read OCC's Strategic Plan because there is such an emphasis and recognition of what the industry is experiencing and what the OCC has been doing for several years with respect to innovation. She stated there is a need for banks to become digitally native, to go on the journey to become more digital, in order to continue to meet the needs of their customers today and in the future. She reported that a key part of the strategic plan is the need to strengthen and modernize community banks and minority depository institutions. Beth reported she and her staff spend a lot of time working with community banks and particularly minority depository institutions about their journey on innovation and digitalization and things that they need to consider as they start on that journey and continue on that path. She reported enthusiasm about the team's Project REACh work and a discussion in that space around what minority depository institutions need to do to prepare themselves for the digital journey. She referenced the team that helped facilitate developing a playbook because you can't just one day wake up and say, "I'm going to innovate, and I am automatically going to be digital." Instead many prerequisites must be put in place to make sure the right resources, the right skillsets, and appropriate consideration of an institution's current

technology, and the things needed to get your technology ready in order to intersect with the new digital format with fintechs and with your core providers.

Beth reported a lot of time has been spent with community banks in particular talking about innovation and what the journey needs to be in order to prepare. She highlighted a couple of things. It starts with one's strategic planning, business plan, and how one will incorporate innovation into that strategic plan.

Innovation, digitalization, technology is really a tool to get you to your strategic plan. It's not the end. It's a means to that end. She reported OCC has seen institutions experience obstacles when the focus is on getting a piece of the innovation because of competition versus being thoughtful about how that technology serves specific business plans and specific customer base interaction with that innovation. That can be more expensive, detract from your journey more quickly than if one was thoughtful up front.

Beth reported the OCC's Office of Innovation is happy to assist banks in the journey. They have conducted meetings with boards and with senior management to help them think about how to incorporate innovation into their strategic plan including understanding the strengths and the challenges that each innovation brings. Innovation could bring a lot of promise. It can accelerate what is being done with your customers. But if you don't understand both the positives and the negatives, like anything else with respect to technology, then you can run into some unexpected consequences.

An example would be artificial intelligence. If you ever thought about utilizing some mechanism of artificial intelligence to perhaps reach out to new customers in ways that you hadn't been able to do before, that type of technology can be extremely helpful in that case, but if you don't understand the data that goes into those models, if you don't set up outcomes that you expect for those models and measure those, you might end up with situations where you are not going to the customers that you expected, or worse case, you might actually end up with a violation of law for treating customers unfairly in the case of a credit underwriting model.

Beth stressed the importance of bankers thinking on the front-end of how specific technology will help them deliver products and services, including the downsides that need to be mitigated before signing a contract. Further she emphasized controls are important regardless of whether the task uses technology or is manually performed. Those controls may be different. Risk should be identified, a risk assessment conducted on the offered product, service, and/or technology to be deployed and appropriate controls to manage the risk be put in place.

Beth encouraged bankers think about is experimenting with innovation in a safe environment such as innovation hubs, accelerators, or labs. Reportedly, a number of the trade associations and states offer these type environments. It's a way to see how those innovations work to get to know the syntax, to understand the people behind these technologies, to determine if they are a good fit with your bank and help a banker decide whether to partner with one or not. This can be done in a way that is not very

costly. The bank can provide resources since these labs are looking for bankers to help provide an understanding of how banking works to the FinTechs that are in those accelerators.

The ICBA for instance has an accelerator that's specifically focused on developing technologies and innovations for community banks. OCC has seen banks have success in these type relationships before they partner or collaborate on their own. Finally, OCC recognizes that into community banks can't do this all on their own and the bankers may need to seek appropriate partners. OCC is also doing work so it can further understand the attributes of those types relationships, which ones are areas that may require more focus from a risk perspective, and what are some of the mitigations to some of those relationships.

From an OI perspective, OCC is involved in all of these things. And OCC has teams that are looking at banking as a service, bank and fintech partnerships, artificial intelligence and machine learning. OCC is also spending time understanding digital assets - beyond crypto, which continues to be a focus. Digitalization of banking is the longer term piece. Crypto is a small part of that. Understanding tokenization and the impacts it will have on banks and the industry in the future is also an ongoing effort. Also we are exploring what it means when somebody has a wallet versus an account? What sort of impact does that have? OCC is spending time in that space.

A committee member indicated it is difficult to conduct pilots as core service providers normally want a long-term contract. She confirmed with Beth that accelerators will sometimes want to pilot what they are doing in a small community bank. Beth also reaffirmed that the OCC is very supportive of collaboration among institutions. There are some institutions gather and talk about different things, how they might benefit, then engage with their core provider, including through user committees and meetings.

Beth stated that the industry is changing, and digitalization is the wave of the future, but how you go about doing that is key to how you think about that and cautiously approach it to not miss the many steps that may be required.

A committee member commented that work done with Project REACh and the cores opened up the lines of communication between bankers and cores at the highest levels. But, integrating, third party processors or third party programs to the cores is tedious, very expensive, very slow, and difficult.

A committee member expressed a desire for the Office of Innovation to have those conversations with the cores. Bankers want the cores to be more flexible and allow for data movement.

The committee member continued with comments and stated a concern with FedNow coming out next year. There is concern the cores are not prepared and community bankers will miss the window of opportunity to compete against the Venmos and the CashApps of the world. Another committee member spoke about concerns with fraud

and how banks tend to get stuck with making the consumer whole even if it is not their product or fault. And, reported with FedNow being 24/7 and 365 days there will be more fraud for the bankers to deal. Committee members noted that convenience and real time payments bring more risk. But convenience and real time payment are desired from the consumer. Committee members were interested to know how much fraud Venmo or Cash App absorbed versus bankers since those platforms use ACH. It was noted that banks are participants in the ACH and rightly or wrongly the system is set up for banks to own that risk. The members hope that as things go real time that someone has thought through how that might exasperate progress and identified the types of controls needed. A committee member expressed concern for consumers that conduct their entire business on Cash App or Venmo.

Beth reminded everyone that as a regulator she/we cannot endorse one way or the other. She gave insight into examples where bankers have indicated some positive success. The trade associations all have innovation groups, or groups that are focused on technology. The National Bankers Association in particular has a group and it may be a good way to see what your peers are doing and to discuss these issues from a peer level. In addition, many trade associations may take the ideas and implement them on their for profit side in terms of some of the products that they then offer their members, or in some of their advocacy and things like that.

Another committee member discussed their definition of a deposit is someone brings them their money, they store it, and they give it back to them whenever they want it back. Therefore, Venmo and Cash App are banks, because they're taking a deposit and going to give it back to me at some point, but not regulated as such. I just think that's a concept that many of you brought in, because they're just operating right on the fringes when the definition of a deposit, gathering service, is that. Beth indicated OCC has seen with this new wave of innovation that the barriers to entry are quite low, and there's been a de-integration of banking. There are lots of different players that are now providing a part of a banking service, or doing something from a customer perspective that really looks like a full banking service when in reality that may not be. There might be a bank behind the scenes. Consumers might assume incorrectly that it has the same type protections as if one engaged with a bank.

This is an area of concern to OCC. The acting comptroller has given several speeches about where the regulatory perimeter begins and ends. OCC is spending time looking at banks and tech partnerships, and understanding the different innovations, and how those services are being provided. It is a journey for OCC too. Banking is really becoming a stack of technology, and we need to understand how that works and where it puts pressure on our regulatory structure.

As Acting Comptroller Hsu said, trust is very, very, very important to banking, and it takes a long time to build it, but no time to lose it. OCC sees that there is customer confusion with some of the leading edge technologies like crypto. Long standing terms in banking are now used differently by others. Consumers may not understand these differences, an example would be yield in the crypto space. Efforts are underway to

address customer confusion. The Financial Literacy Education Council, for instance, is focused on crypto literacy precisely so that customers know what they're engaged in.

A committee member asked how MDIs should engage with OCC? What has been successful for MDIs on an individual basis, or an association basis? Again, we all represent not only our own institutions, but many other colleagues. There's a lot of information amassed, and strategies and the like. How does it happen? How does it work on the ground? Have you seen it more successful? How are you set up to do it?

One of the Office of Innovation’s key pillars or components is providing technical assistance to banks. We want banks to share their innovation journey with the OCC. We get the right people in the room to talk and those have been received by the banks. The best way to initiate those discussions, is either bankers can come to the OCC or the OCC can come to bankers. Once the pandemic subsides and travel commences OCC will start bank visits. If bankers reach out to their supervisory office, the supervisory office can reach out to us, and we can set something up. The Office of Innovation will tailor presentations to a particular interest. Presentations can be broad such as “How do I start to incorporate this into my business plan?" or address a specific topic such as Agile development. In that case the Office of Innovation did a presentation specific to Agile development.

Project REACh Update

This summer Project REACh surpassed its two year mark for the initiative convening national and local stakeholders to increase financial inclusion within economically disadvantaged communities and communities of color.

In July 2022, OCC hosted a symposium to highlight some of the developments within the work streams focused on affordable housing, small and minority businesses, and inclusion of the credit invisible population. Immediately preceding the symposium’s kickoff, OCC held our MDI collaboration round table, which provided presentations on MDI technical assistance needs, or executive-owned loan offerings by larger financial institutions, market growth and investment strategies, as well as collaborations with core providers, fintech, and then Ernie's update on the state of MDIs supervised by the OCC.

The MDI revitalization work stream, had two dedicated subgroups, one for technical assistance and one for innovation. The participants in the technical assistance subgroup are exploring a schedule of webinars for MDIs to provide them with strategic planning considerations to support the safe and sound deployment of their new capital resources. The other subgroup, led by Beth's team, our Office of Innovation, the participants are concentrating on ways to innovate their technological printout forms to improve the banking experience for MDI customers. This group is finalizing an innovation playbook on how banks can work to integrate technology at their banks, including their transition strategy from legacy systems which may not interface with newer technologies.

In October 2020, OCC launched the locally-focused administration of Project REACh in Los Angeles. It was OCC’s first foray into creating collaborations between local banks

and community groups. As many of you mentioned, establishing a local presence helps to understand community and industry needs. Over the last year, four additional local demonstrations of Project REACh were launched in Washington, DC; Detroit, Michigan; Dallas, Texas; and Milwaukee, Wisconsin to bring together stakeholders and communities dealing with economic inclusion challenges.

Considerable work was conducted on negative housing needs and a white paper on accessory dwelling units within the home ownership subgroup. In the small or minority business work stream, participants developed a white paper on the need for technical assistance to improve small businesses access to capital and they are working on finalizing of the creation of a resource hub for banks interested in establishing a special purpose credit program.

In the inclusion of credit invisible work stream, some of the largest banks established a platform to use deposit account transactions as a waterfall structure based on traditional credit risk models. This will provide a second look to their consumers for credit approvals for either a credit card or other small dollar retail credit product. At a prior meeting, this effort was a pilot launched by one of the participating banks. Now, several larger banks are participating. Next this group is looking to develop models that consider alternative data for the ability to repay criteria

A committee member asked Andrew if there is an opportunity for a community bank to become involved in the credit invisibles work stream since they are on the ground in the minority communities. Andrew stated there is opportunity. And, that they are trying to address volume as the larger banks have millions and trillions of data points and there is a need to aggregate as well as protect the privacy needs of each of those institutions. There is a need to lag sometimes, get it right and not be in violation of any regulatory requirements. Some FinTechs are working to compile information with the core providers and others so they can create a model similar to AWS or others that are working to provide those data attributes. That effort will be more focused towards the smaller community banks.

Beverly thanked everyone involved for their contributions to the MDIAC, Project REACh and other projects. Also, Beverly asked the group to consider meeting with OCC's Mutual Savings Association Advisory Committee (MSAAC) which is working on some issues that are aligned with the MDIAC. She suggested perhaps we could have a joint meeting in June 2023.

<u>Acting Comptroller of the Currency Hsu and MDIAC Roundtable</u>
ACoC Hsu stated the MDIAC was an excellent advisory committee for OCC and the charter had been renewed. He stated that for MDIs there is money, interest and other things. So, the problems are shifting in some cases into high class problems, such as how do you grow, how do you deepen relationships? And that conversations that started with the MDIAC are now happening outside of this group and including other bankers and that is a great sign. ACoC stated OCC's MSAAC membership expressed an interest in MDIs and had some ideas and interest in collaboration. He noted OCC's

first MDI de novo charter in 13 years - Agility Bank in Houston, Texas. He further mentioned the de novo mutual charter in New Hampshire (not OCC chartered) and not yet approved. ACoC reported these are healthy signs.

Generally, committee members thought it was an excellent idea to join forces with the MSAAC and expand bandwidth, collaborate and work together and perhaps get more accomplished. It was thought that if the two committees joined forces they could have more impact and more efficacy than if standing alone.

A committee member stated that some of the initial meetings we talked about capital, innovation and all these things that were at that time foreign. And now MDIs have more capital in some cases than we can really quite frankly put to work. But number two, there's also a lot of opportunities. The MDIs have discussed the fact that so many people are calling the MDIs (larger banks, non-banks, FinTechs,etc.) and now MDIs have to decide which opportunity to take. It is a good problem to have but also there is fear to ensure while getting into new areas one does not trip and that the OCC both understands what is done is agile and is lenient with the MDIs as they try to do the right thing and deploy the capital. Fear because MDIs are now chasing different projects with a lot of capital which is great but also a new area for the bank – 180 degrees from a few years ago and a testament to Project REACh.

A committee member reported that the group discussed PPP earlier and how in the CDFI and the MDI spaces, it actually meant something as with prior deposit gathering programs MDIs were not successful in getting into them.

The ACoC indicated there are more tailwinds within the MDI space and we are starting to see this abundance of opportunity or opportunity overload with CEOs who are trying to determine which project to dedicate time and bank resources toward. The ACoC agreed that had not been the discussion in prior years. And, that there is uncertainty around how long the attention and opportunity will persist. So, now is the time for institutions, the OCC, and other partners to figure out what are those things that can be done, institutionalized and provide a long-term benefit. Some of that is the growth and support of institutions, but some of it is policy related. Some of it is developing partnerships into something that will be mutually beneficial over the next 10 years despite changes in the economy, etc.?

The committee members indicated they are interested in relationships and not transactions. As a result, when various companies approach them they attempt to: (1) access whether the intent is a transaction or sustainable relationship that the company plans to pay attention to, (2) determine what can be done to fulfill and widen those relationships, and (3) assess what can be done to work together with the technology and with the people that have the technology and institutional knowledge that MDIs are trying to acquire as they grow.

ACoC Hsu stated within Project REACh, OCC tried to accomplish that through the pledge and asked if the pledge was helpful. A committee member reported that the

MDIs have discussed this topic among themselves. And, wondered if an internal report card or open dialogue would help spur competition amongst the larger banks. Some of the MDIs are now in a different place and wondered whether deposits at MDIs being 100% FDIC insured could eliminate the need to the variety of unique deposit structured products? A committee member indicated that Apple does not bank with his bank because their deposits would not be FDIC insured. They also indicated the CDARs Program is a unique program and not ideally what they are seeking. Others found that larger banks' treasury functions are not interested in 20 relationships but would rather have a relationship with a smaller number of institutions. Another committee member indicated despite sending letters to banks looking for deposits the institution only received one positive response in return in the amount of FDIC insurance.

Another committee member indicated that uncertainty on whether the pledge itself spurs the competition. But it is a good tool. However, with some associations, particularly the larger financial institutions are looking at what their colleagues are doing. MDIs notice the differences in execution. So, you'll have some institutions that are not just having an individual, now they're really developing infrastructure. And MDIs must take advantage of the moment to build infrastructure just as the OCC or Project Reach.

The committee membership thought the cores are a great land of opportunity for all community banks, and given the interest in MDIs and smaller institutions, but given the imbalance of power, it is a challenge. Some thought there is an opportunity to bring presume to the cores and frankly discuss how they are helping to ensure the longevity of the institutions with which they partner. The membership acknowledged that each core expressed their desire and interest related to Project REACh and although slow in coming is beginning to happen. There is hope that the more it is elevated and the more persons that are engaged the more effective it can be.

Another committee member shared an experience with a core where there was not a choice of product and later discovered their bank was the guinea pig for the core's new product. The product had lots of issues and the bank suffered through those issues without sufficient assistance from the core.

Another committee member shared the core no longer supported a product which forced the banker to move to another core which was expensive. And thought collecting exit fees from small bank's may be a product line for the cores.

A different committee member stated MDIs/CDFIs must build their infrastructure over time. They cannot expect OCC to solve those problems. The committee member stated having working groups, checklists, etc. are helpful and collaboration is sometimes difficult since not every MDI has staff to dedicate to a working group. There is a need to share lessons learned, how to you handle core, start in advance to renegotiate exit fees, share bad lessons, and devise plans and all group together. This committee member stated banks now have capital and need to take the responsibility to build out their infrastructure. Also ensure MDIs should work with each other rather than being in competition with each other. The member also stated the MDIs must have resources

vested in your business so you cannot hire a consultant. The committee member stated the OCC provides a lot of support but can only do so much. Now MDIs need to determine how they can help others expand their knowledge base through collaboration.

Yet another committee member shared that band width is a problem that everyone has MDIs, larger banks, cores, etc. ACoC Hsu stated that collaboration and information sharing can be helpful and will go from a nice to have to a need to have. He also acknowledged that band width is a constraint and the key to survival.
The Acting Comptroller asked what could be done to help institutionalize those kinds of networks? A committee member thought the playbook developed on the innovation working group on due diligence was a step in the right direction. Another idea would be how to approach the core – do's and don'ts when renewing the contract what leverage do you have? The group realized the problem is one for not just MDIs but for all smaller size banks. There is a desire to share the information with others. A playbook for board memberships could be helpful. How do you choose a board?
Acting Comptroller Hsu stated that OCC will need to think about the way we usually do things – guidance and supervisor feedback. And there is clear lines of demarcation and processes. Project REACh is where OCC is a convener. OCC provides the coffee and the working group provides the ideas. Acting Comptroller Hsu stated OCC will have to think about how best to operationalize the convener role while providing the benefits the committee members discussed.

A committee member stated the OCC has an opportunity to learn as well. In the community bank and MDI space how could compliance burdens be lowered? Further, there is a great opportunity for MDis to not be held to CRA because by their very nature, they are already complying. CRA was never the problem for MDIs because MDIs are the definition of taking funds from our community and reinvesting it and supporting those communities.

Another committee member said from a compliance perspective, BSA/AML is impacting every bank. Acting Comptroller Hsu discussed changes in the industry with FinTechs and banking as a service. Banking is a high trust business. Mistakes are costly to consumers, costly to the trust of banking, and so that's why there's so many different regs. That's why there's so many different systems to check a lot of those things, and the technology firms don't always know that. The technology approach is different than the banking approach. Now the better door works, it's just different, and that has to be acknowledged.

If you're now partnering with someone, okay, now you've added some complexity. If you're partnering with someone who's now partnered with someone else, now we've really added a lot of complexity, and I'm not sure all of that has been worked out, and that's just on a straight business as usual basis.

A committee member referred to the prior Cash App and Venmo discussion. Acting Comptroller Hsu said people focus on convenience. That's natural, and the technology

firms are very good at convenience. That's natural, and the technology firms are very good at convenience. Very slick looking app. It works, you hit a couple things and it works. When times are not good, people look for reliability, and these are sometimes intentional with each other. He stated in the crypto world a lot of folks were surprised that their deposits were not insured by the FDIC when it's plain to everyone that it is not an FDIC-insured deposit. Yet some people had gotten used to that as an idea, like, "Oh, I parked my funds somewhere. There's a bank somewhere in the picture, it should be FDIC insured," and that's not the case. FinTech world's the same thing, and closure can only get you so far. OCC is thinking about this and wants to level this playing field.

A committee member stated if FinTechs took services the banking industry should have done but did not. It was suggested that regulators send a Cease and Desist letter to FinTechs. The Acting Comptroller indicated it is more complicated than it seems. He thought the issue is on the payment side where historically if you wanted to take deposits, make loans, and facilitate payment, you had to get a bank charter. There was no choice. You had to either come to the OCC or go to state and go through the chartering process.

Fast forward now companies are providing payment solutions, Square, PayPal, peer-to-peer. These are just payments, so it's not banking, but it evolves over time. When it accumulates cash - you hold cash there. And, it is more like money in your wallet. And it is a like a deposit. Then, if you want credit with that, it feels like it's got some borrowing aspects to it.

Those, business model-wise, make total sensed are logical partly because the banking system didn't provide the services in a way that was better for customers. Basically banking has been unbundled and then rebundled outside of the bank perimeter. So, that is something that we need to work on.

Interestingly, FinTechs can't do it alone. They have bank partners and they have to get into the banking system eventually. This is something we're trying to focus on in those kinds of relationships. Some of this gets termed as banking as a the service. Is it fair? Is it providing for a level playing field? Is there some kind of arbitrage going on? The rent to charter is the worst poster child case of that. That's for the most part been addressed. But there are more subtle versions of this, which required a lot more work and engagement on our part.

<u>Announcements</u>

First the next convening of OCC's MDI Technical Assistance Working Group is scheduled for Thursday, September 29, 2022 from 3:00 to 4:00 PM Eastern Time. Interested parties should contact BJ for the link.

October 6th and October 17th, OCC has worked with an interagency coalition to hold listening sessions with MDIs to hear more about topics of interest, things you are needing and making sure the Interagency MDI Conference is tailored to topics of

interests to MDIs. The October 6th session is tailored towards CDFIs, and that will be from 3:00 until 4:30 Eastern Time. The October 17th, session will be moderated by the OCC, it will be from 1:30 until 3:00 PM Eastern Time.

Charlotte Bahin reminded those that might be interested in the nomination and the membership processes that the committee was renewed for another two year term. The membership is also for a two year period, but it's not exactly the same. For example, the committee is renewed every other year in June, and the membership goes until the end of the year, so you all are still members until December 31st.

OCC published a notice in the *Federal Register* and did some outreach with banking, both state and local banking trade groups, and also with the leadership here at the OCC to get a group of nominations. The nomination period has been closed. Some of you have submitted nominations for yourself or for other people.

Even if you have submitted a nomination for yourself and we go through the process of reviewing all the nominations, we have to follow something that's a Federal Advisory Committee requirement for a balanced membership, so we have to look at all aspects of balance, including geography, size, operating strategy, but also for this committee, minority status. So we look at all of those items and comprise a membership that's representative of the MDIs supervised by OCC.

Members of this committee, all serve as representative members. If you are seeking to renew your membership, everyone goes through the background review process again, which means the FBI check, the tax ID check. It also means that it will take, just like it has every two years since the very beginning, a long time. Hopefully the government won't close, and there will not be some unforeseen disaster and we will move through the process quickly.

The steps are that we'll send out the forms to the slate of nominees, get them back to our security office. So, they don't come to me, they don't come to Beverly or anybody. I mean, we are not the people that touch those forms except in a redacted version later on. We send a memo to Treasury that explains the factors for why the slate is the one that we've selected. It is reviewed by somebody at Treasury and it goes through an approval process there. Then that comes back, and we have another approval process that includes the acting comptroller and the assistant secretary at Treasury for management. These steps all have time periods that are built into the rules, so some of them are 45 days, some of them are 30 days.

It is a protracted process. Hopefully a new committee will be seated in time for the first meeting in 2023 and we will be able to let the new nominees know that they've been selected, approved, field stamped, etc.

Charlotte volunteered to talk to anyone that had questions offline since the questions are normally fact specific.

Public Comments

There were oral comments expressing appreciation for the level of engagement and candor on both sides in today's meeting. Also a comment regarding appreciation for the work Andrew Moss does with Project REACh.

Tegan the event producer, shared that a question that came into the chat. Is there an ETA for the playbook that is being created? I would say no, there is not an ETA for that. OCC cannot issue a product that is not solely OCC-derived. There have been discussions around the topic and Andrew Moss is better equipped to address this question.

Adjournment

Beverly thanked everyone for participating and wished those traveling safe travels.

/s/ Beverly F. Cole