WesternBanker

ISSUE 1 2020

A PUBLICATION OF WESTERN BANKERS ASSOCIATION

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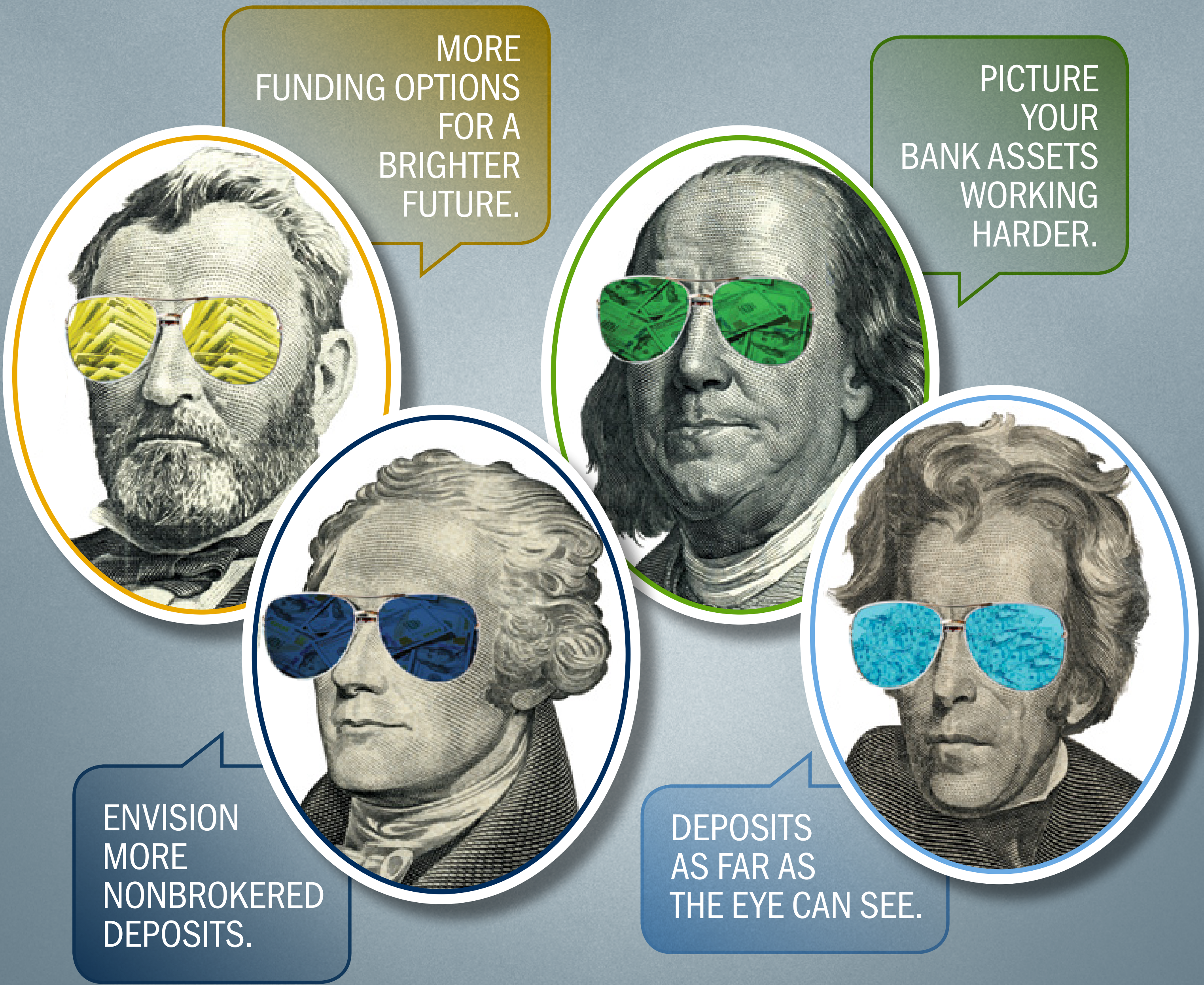

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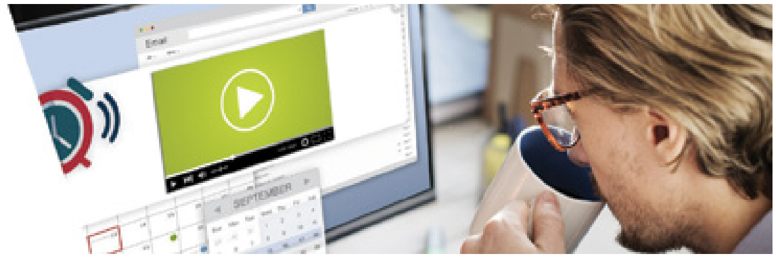
Webinars



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Questions? Contact Montana Townsend at (916) 438-4427 or mtownsend@westernbankers.com

MARCH

- Utilizing Cash Flow Projections to Determine Repayment Ability
- Non-Executive Compensation Concerns (Staff Level)
- Turning up the Heat: Board Fiduciary Duty Update
- Strong Third Party Risk Management (TPRM) Practices – Part III: Monitoring and Reporting
- Start with Strategy: How to Build an Inclusion-Centered Diversity Program
- 2020 Proxy Season Update
- Credit Analysis Basics
- Write Right to Better Business Communication
- CRE Concentration Management
- Human Trafficking – Closer to Home Than You Think

APRIL

- The 5 Cs of Credit
- Technology's Role in Growing the Community Bank of the Future
- Construction Lending Fundamentals – Building Blocks for Sound Banking
- Profit Is Not a Dirty Word: How to Assess a Borrower's Operating Performance
- Advanced Financial Statement and Tax Return Analysis
- Ten Strategies to Remain Independent in a Consolidating Environment
- Macro and Micro Musings on US Economy
- Reg CC Final Rule Changes: What Banks Need to Know

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WESTERN BANKERS ASSOCIATION

The Banking Industry Is Here To Help During The Coronavirus Pandemic

Banks are ready to help their customers and communities during this time of need.

Since the beginning of this emergency, banks have been outreaching with customers to minimize the adverse financial effects on our communities as we navigate through this situation.

It's important to know that banks have well developed business continuity plans designed to address these kinds of emergencies, including pandemics, to make certain that they can keep doing business.

Banks are actively monitoring the latest reports from the Center for Disease Control and taking numerous precautions to help ensure the safety of their customers and employees. Banks are implementing remote work policies for non-customer facing staff, increasing social distancing measures for all customer-facing staff, and restricting staff travel.

As this emergency has evolved, banks have been communicating with their customers describing the ways in which they are responding to the crisis and providing options and relief to impacted customers.

USE MOBILE BANKING OPTIONS

When possible, customers are being encouraged to access their accounts from home to monitor their accounts to check balances, make payments, transfer funds and deposit checks.

SUPPORT FOR SMALL BUSINESSES, INDIVIDUAL HARDSHIPS

Many banks are also taking steps to accommodate affected customers through hardship programs, small business support, extended banker availability hours and other measures to address individual circumstances.

CONTACT YOUR BANK

Given the unique nature of everyone's personal financial situation, customers experiencing hardships should reachout immediately to their financial institution to discuss their specific circumstances and understand what assistance may be available.

INFORMATION FOR CONCERNED HOMEOWNERS

Homeowners concerned about upcoming mortgage payments, should know that state and federal law contain extensive borrower protections, which require mortgage servicers to engage in conversations with distressed borrowers to explore alternatives to foreclosure. If you are concerned about your ability to make a mortgage payment, please contact your mortgage servicer immediately.

BE AWARE OF SCAMS

It's important to be aware of scams and remain vigilant to imposters and fraudsters that may use this emergency to obtain personal information by sending phishing emails with links or attachments.

As needs arise, our members will continue to closely monitor the situation and evaluate additional measures to support their customers and communities.

Content

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WESTERN BANKERS ASSOCIATION

FEATURES

DEPARTMENTS

View this issue and past issues of WesternBanker online any time at www.westernbankers.com

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WesternBanker, Editorial

Industry Overview

Stephen G. Andrews
President and CEO
Western Bankers Association
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The new year started strong for the WBA, hosting a successful Bank Presidents Seminar, Jan. 6-9, in Santa Barbara, California. We were pleased to welcome nearly 100 bankers and more than 200 attendees to this annual event where our member bank executives have great opportunities to network, reconnect, and hear from leading keynote speakers. This year we were fortunate to have keynote addresses from Steve Hatfield, who is leading Deloitte's Future of Work Global Practice, Rich Karlgaard, founder of Forbes, and one of the most respected figures in the economic, business and technology worlds, as well as an engaging economic forecast from Beacon Economics founder, Dr. Chris Thornberg.

As we have had the opportunity to share with you recently, we are excited to offer a new lineup of conferences for 2020, bringing back successful conferences of the past, including our Regulatory Compliance Conference and our Women in Banking Forum. The latter, I am particularly excited to reintroduce and support, especially after hearing many encouraging comments from prior event attendees about the important role this event has played in the development of future women leaders, providing them with vital networking opportunities, chances to connect with mentors, and the opportunity to hear from successful and inspiring women executives. This year we will host the event at the Balboa Bay Resort in Newport Beach, California, April 29-30. We have developed special pricing for this event, which hopefully will encourage you to send multiple employees from your bank. We have secured Scarlett Sieber, who is recognized as a top fintech influencer, as one of our keynote speakers, and are excited to announce additional keynotes soon.

We are also changing up our annual visit to Washington, D.C this year, and will hold our visit March 23-25, in conjunction with the ABA's Washington Summit. The largest gathering of banking industry leaders in the nation's capital, the Summit provides a great opportunity for bankers across the country to meet with lawmakers, regulators and administration officials to help ensure that banking policy continues moving in the right direction. You do not need to be an ABA member to join us and help advocate on important industry issues with our nation's lawmakers and regulatory officials. We remain positive that a solution can be reached to allow marijuana-related businesses access to the banking system, and that meaningful CRA reform will materialize, despite the Fed's reluctance to join the OCC and FDIC on their reform proposal.

Finally, I would like to thank you for your ongoing commitment to membership with the WBA. The staff and volunteer leadership of the association are committed to ensuring that we are continuing to deliver on our value proposition. Our signature events remain a significant value for all of our members with conferences in unmatched locations, featuring notable keynote speakers and the greatest opportunity to network with your peers and check out the organizations offering cutting edge products and services to our industry. For our California bank members, we remain the only state banking trade association with a full-time team of in-house lobbyists who are a constant presence in our state Capitol advocating on behalf of our members to ensure a level playing field for all financial service providers in the state.

Our signature events remain a significant value for all of our members with conferences in unmatched locations, featuring notable keynote speakers and the greatest opportunity to network with your peers and check out the organizations offering cutting edge products and services to our industry.

I look forward to several opportunities to connect with you in the coming year. This year, we will host nearly 20 regional roundtables across our western states' footprint, and I hope to see many of you at one of these events. I also encourage you to connect with me on social media via LinkedIn or Instagram (@wbaceo). We remain committed to being your voice and top resource for industry advocacy, education and events, communications, and endorsed partners in 2020. »

Steve

Stephen G. Andrews
President and CEO

2020-2021 Conferences

- **2020 Education Summit**
  Manchester Grand Hyatt San Diego
  San Diego, California • September 1 – 4, 2020

- **2020 Regulatory Compliance Conference**
  Caesars Palace Las Vegas
  Las Vegas, Nevada • October 6 – 9, 2020

- **2020 Bank Counsel Seminar**
  Caesars Palace Las Vegas
  Las Vegas, Nevada • October 6, 2020

- **2020 Lenders & Chief Credit Officers Conference**
  Ritz-Carlton, Laguna Niguel
  Dana Point, California • November 3 – 6, 2020

- **2021 Bank Presidents Seminar**
  Four Seasons Biltmore
  Santa Barbara, California • January 12 – 15, 2021

- **2021 Annual Conference & Directors Forum**
  Fairmont Orchid
  Island of Hawaii • April 8 – 13, 2021

To register for 2020 WBA conferences or ask questions,
contact Lori King at lking@westernbankers.com.

Considerations for Successfully Defining Your Target Market

By Julia A. Gutierrez, Compliance Alliance

Watching the Super Bowl is as much about the commercials as it is about the game. If you stop and think about it, all the commercials are geared to a target audience. Simply put, target marketing is aiming your product or service towards a specific group of potential consumers. It involves concentrating your marketing efforts on a group of consumers who are most likely to buy and use your product. It can be the key to success for a business because marketing to the right group has the potential to attract new business and increase sales. Most successful business owners would agree that target marketing is one of the first steps in a good business plan and the most effective way to optimize your resources. As simple as the concept of target marketing may be, several challenges coincide with that notion. A great deal of brainstorming and planning are essential steps in the process of determining who should be included in this target group and what products or services would be most beneficial.

You wouldn't dive into a body of water without having some idea of what you're jumping into. Most importantly, you would find out about the depth, threats, or elements that could get in the way of a successful dive. Target marketing is no different. If you are going to dive into a very specific market, there are several factors to consider. So, let's talk about how this applies to financial institutions. In a perfect world, we could offer a "one size fits all" financial product and be perfectly successful, but unfortunately, it's not that easy. A range of factors should be considered to ensure you are effectively and efficiently reaching a targeted group of individuals who will benefit from the products or services being offered, resulting in the increase of sales and business. Before you can clearly define your target audience, you should, at a minimum, consider the following factors.

Identify and Analyze

What type of product or service are you planning to market? Determine the features or characteristics you plan to incorporate into your financial product and then outline the benefits that the product may provide. Identify your potential customer base. Analyze your current customers and the products and services they are utilizing and think about whether other potential customers may also utilize these financial products or services. Often there is a correlation between certain products and the individuals using them. Therefore, evaluating the common interests and characteristics of your existing customer base may be beneficial to broadening that customer base. Identify the features and benefits of the products or services you are planning to offer. Determine how your product or service, based on its highlights, can improve the consumers' life, whether that be free ATM costs or low-interest lines of equity.

Demographics and Psychographics

Determine who may need the financial product or service you are considering. Take into consideration who will actually buy or utilize those products and services. This means first looking at your geographical location to establish the size of your potential marketing area. Build onto that concept by considering factors such as age, sex, income level, occupations, marital status, or the backgrounds of the targeted area. Psychographics include more personal characteristics. When analyzing your demographics, consider influences like lifestyle, behavior, interests or hobbies of the individuals your marketing group would include. For example, if you are planning to market a financial product in a college town, it would be advantageous to consider factors such as age, income level, and interests of your targeted area. These factors alone give you a clearer idea of what delivery methods may be the most effective for reaching your based targeted group, and that, in turn, leads us into the next area of consideration.

When analyzing your demographics, consider influences like lifestyle, behavior, interests or hobbies of the individuals your marketing group would include. For example, if you are planning to market a financial product in a college town, it would be advantageous to consider factors such as age, income level, and interests of your targeted area.

Marketing Resources and Methods

Often, we get caught up in using methods of delivery that we know are successful based on past data. Unfortunately, in the ever-evolving world of technology and social media, we may be selling ourselves short if we rely on the past when it comes to marketing. The targeted audience must be the focal point when choosing the best approach for advertising a specific set of financial products and services. If your audience is unlikely to use social media, perhaps a paper brochure would be an excellent form of marketing. However, if your audience is technologically driven, social media may be a better form of communication. The goal is to determine the best way to ensure your targeted audience receives your message.

Competition

What's better about the financial product you are offering than your competitors? Conduct an analysis of your competitors' offered products and services, as well as the customer base they are targeting. If your financial institution is offering the same product or a product with similar features, you want to either target a different area or uncover a niche in the market that they may be overlooking. If it seems like everyone in your area is focused on loan products, offering a deposit product with better features and customer service may just the right idea to beat out your competition and expand your customer base. And who knows, you may be able to offer that loan product after all if your marketing can get that potential customer into your financial institution.

Regulatory Compliance and Limitations

Compliance and constraints are always crucial factors that must be considered in marketing. Regulatory limitations can put a real damper on an entire marketing plan if not carefully researched and resolved. Now more than ever, regulators are taking a closer look at the marketing and advertising efforts of financial institutions. Words such as unfair, deceptive or abusive are those scary areas of compliance that we are all trying to avoid. While there are plenty of regulations that govern the marketing of financial products and services, if you are clear, concise, and fair, that is half of the battle for success from a regulatory standpoint. The considerations noted above serve as a compass for the direction to focus your marketing, but keep in mind that the final goal is to achieve a successful plan for target marketing while also serving your market fairly. Although you may focus on a target audience, keep in mind that this does not limit your customer base to that target group. After all, the utilization and benefits of your products or services should be offered fairly and equally to anyone meeting the requirements or standards of the offered product.

Conclusion

In the dynamic world of marketing, targeting your audience is the key to success. Focusing on the considerations discussed throughout can be the difference in defining your target audience and meeting those sales goals or leave gaps and failing to meet those objectives. Once you've met the challenge of targeting your market, assess your decisions and be willing to change your audience as the market evolves. Remember, the key to success is getting your message out.

Julia A. Gutierrez brings years of financial industry experience to the Compliance Alliance team. She began her career in banking in 2000 while receiving her Bachelor of Business Administration degree in finance from the University of Alabama. Julia has served as a risk management and BSA officer, assisted in the development of an enterprise-wide risk management and compliance program for a de novo institution, assisted in the compliance remediation efforts for an institution referred to the DOJ, and was a senior compliance advisor for a large regulatory compliance consulting firm. In addition to her experience in the financial industry, Julia also serves as a commissioned officer in the United States Army Reserves. As a compliance officer with Compliance Alliance, Julia works in the education department, where she is a presenter for compliance training, seminars, workshops and conferences nationwide. She also assists with policy and document reviews, research and development of new training material, and product development.

Future-Ready Customer Service Can Drive Growth from Here

By Mary Ellen Biery, Senior writer, content specialist, Abrigo

Local, personal customer service is a longtime hallmark of community financial institutions. Indeed, it is customer service that has set apart community banks from their larger rivals for decades.

However, the biggest banks in recent years have tried to narrow the service gap. They expanded their branch footprints and put "boots on the ground." They, along with alternative lenders, have utilized technology to make it easier and faster for some business customers to get financing or find out about other services. The technology has also allowed these firms to generate sufficient returns on smaller business loans, making business loans more attractive growth vehicles. PayPal, Amazon and other alternative digital lenders, in particular, are using technology to tap into business-customer insights related to sales and available collateral so that they can offer loans tailored to each small business.

Community financial institutions that double down on customer service will find they are able to not only cement relationships with existing customers but also grow by:

- Gaining new customer accounts,
- Increasing deposits, and
- Booking new and larger loans.

Just as technology allowed alternative lenders to address unmet customer needs, technology can bolster customer service at

community financial institutions in a way that unlocks growth. Banks with future-ready customer service aided by technology will be able to win loans and new deposits.

The case for doubling down on customer service

Financial institutions acknowledge the tie between technology, customer service and their own institution's success. In a recent Cornerstone Advisors survey of more than 300 community-based financial institutions, 82% said improving the customer experience was a "very important" business objective of their plans for fintech partnerships, collaborations, and investments. Improving the customer experience topped the list of business objectives, beating out reducing operating expenses, reaching new customer segments, and reducing fraud.

This prioritization by bankers is understandable. After all, consumers, in general, are ready to reward better experiences with increased spending. A 2017 study by consulting firm Capgemini found that 79% of retail banking consumers, in particular, are willing to pay more for a better experience.

How exactly does technology allow banks to improve customer service and grow? Here are a few examples.

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Technology makes it easier to identify, track customer needs

From front-line tellers to back-office staff, everyone at a financial institution can improve customer service and help grow the bank when they can identify products or services a customer needs. The last thing a bank wants is to lose a business loan or an entire customer relationship because the customer didn't know their bank offered business loans and therefore sought one from a competitor. Worse yet is when a customer requests information on a business loan but is never moved further down the sales pipeline because the lead "falls through the cracks" of a system based on handing off leads via sticky notes, business cards and phone messages.

The right customer relationship management software helps the bank enhance customer service and cross-selling, manage its sales pipeline, and identify business development trends. It provides a complete, 360-degree view of each bank customer. Pulling in data from the bank's core and the lending platform, it provides real-time, aggregated data that gives bankers a comprehensive picture of the borrower, their business relationships and opportunities. "If a bank worker in a branch has a conversation with a depositor who walked in the door, they can log that information in the CRM, so that the lender will see that a business owner named Phyllis came in and was talking about how her business needed some funding to expand," says Abrigo Credit Consultant Mike McCaffery. "That way, the lender knows about the lead and can reach out and follow up quickly."

The CRM solution makes it easier for the banker to track each interaction and opportunity — with customers and potential customers alike. It also reduces duplicate data entry to hasten the onboarding process once a new loan is underway; this frees up lenders to have more actual "face time" with customers

> This prioritization by bankers is understandable. After all, consumers, in general, are ready to reward better experiences with increased spending. A 2017 study by consulting firm Capgemini found that 79% of retail banking consumers, in particular, are willing to pay more for a better experience.

and prospects to discuss needs and to cultivate relationships, McCaffery notes. In addition, a CRM helps bankers stay organized so that they maintain the personalized attention that distinguishes community financial institutions. "You'll know John's birthday is on May 28, so you'll get a reminder to give him a call," McCaffery says. "You will not be missing things."

All of these actions show customers and prospects that the bank values their business and is looking for ways to expand the relationship.

Technology makes borrowing easier, faster

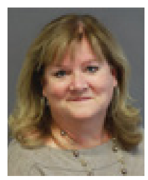
Tapping into technology advancements that streamline origination and onboarding will translate into an easier business-loan application process and faster credit decisions. Creating a superior customer experience through an online loan origination system will set the financial institution apart and support growth. After all, long wait times for credit decisions and difficult application processes are the chief complaints among small-business loan applicants at traditional banks and credit unions.

The bank can win new customers (and their deposits) as business owners shop around for a loan. Some business owners might initially look to alternative, higher-fee online lenders for the sake of convenience and speed. However, many would rather work with a trusted traditional lender offering a comparable process with lower rates and fees.

McCaffery notes that an online loan application platform can also help financial institutions hold on to an important customer group. If an older business customer is in the process of handing down his business to adult children, those next-generation business owners are likely to place greater importance on the bank's technology capabilities than their parents did as they consider a financial partner. "It's a turnoff if those next-generation business owners go to a bank's website and there's nothing digital there," he says. "If the website looks like it's from the 1970s, it could be tough for the bank to grow loans, because any new business owner will look at it and say, 'This is going to be so hard to work with this bank, we'll probably have to find a new bank eventually.'"

Technology that allows borrowers to deliver all required documents for loan applications and annual reviews securely to an online portal also provides better customer service that aids growth. Bankers will spend less time on the road collecting documents, and credit files can be completed and tracked more quickly. Clients will also spend less time responding to emails and digging up copies of documents.

"The value of a community relationship with a banker is tangible," McCaffery says. "Married with technology, it allows someone to have a better experience, and that superior customer service is what will grow the institution."



Mary Ellen Biery is a senior writer and content specialist at Abrigo, a leading technology provider of solutions that community financial institutions use to manage risk and drive growth. She is a former financial reporter for Dow Jones Newswires whose work has also appeared in The Wall Street Journal, Accounting Today, on CNBC.com, Nasdaq.com, Forbes.com, and other sites.

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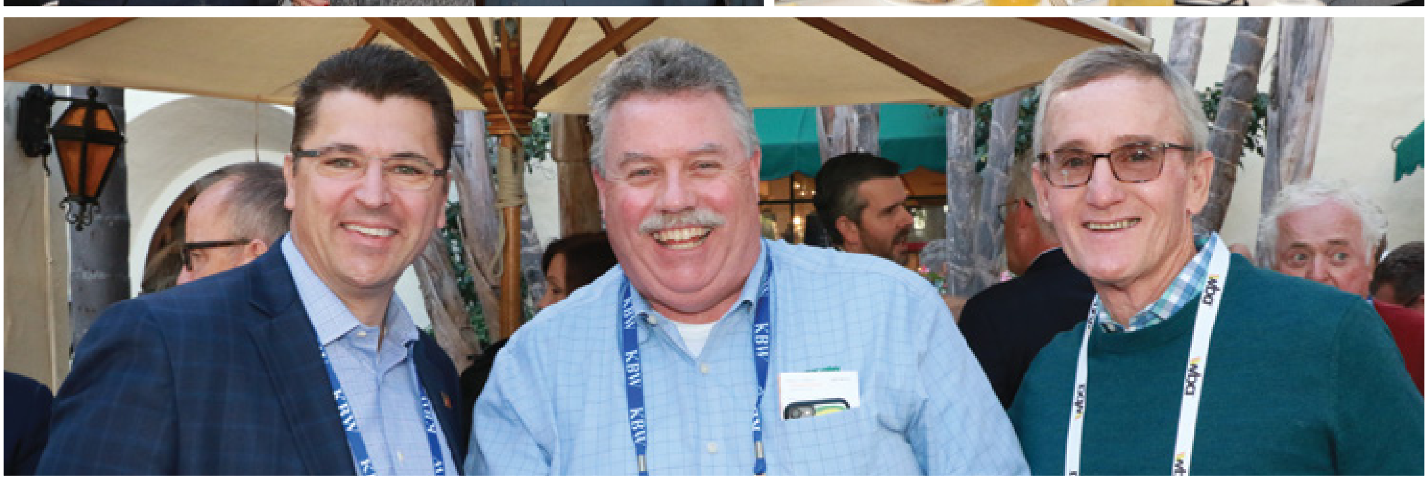

Deposit Issues to Dominate Community Bank Woes, but M&A Can Solve Them

By Adam Mustafa, CEO, Invictus

The biggest problem community banks will face in the next few years, all things being equal, is deposits. The post-recession decade, marked by the Federal Reserve's quantitative easing policies, changed the banking industry. Big banks de-emphasized deposits as interest rates neared zero. A generation of bankers structured their banks to grow assets. Even if interest rates go down, the growth of the money supply is not likely to increase significantly without additional QE. Unfortunately, we are only likely to see more QE in the face of another recession; at that point, banks have much bigger problems.

Now everyone is scrambling for deposits — and the big banks have the upper hand with the most expertise and largest budgets in marketing, software, advertising, social media, customer outreach and more. The next three or four years will be tough for community banks, as they struggle to maintain their growth and profitability.

Even with a 25-basis-point decline in the federal funds rate, the cost of the next dollar of funding will be based upon the market rate for CDs and the latest pricing from wholesalers such as the FHLB; this means that the next loan that is made by a bank that is loaned up and without any excess liquidity will have an incremental funding cost of somewhere between 2.0 and 2.5%. In turn, this will cripple the incremental margin of making new loans. Many banks have resorted to selling pieces of new loans or entire new loans for a small premium that jacks up today's earnings but sacrifices earnings over the medium- and long-term.

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The smaller the bank, the more likely that deposit growth failed to keep up with loan growth. Nearly every community bank is starting to feel pricing and volume pressures on its deposit base. They are falling back on variations of historical deposit gathering techniques that will only have minimal impact. Organic growth strategies such as rewards programs and pumping up your tellers may help, but if all your peers do the same thing, it will negate the impact.

Many community bankers do not recognize the problem, primarily because they are relying on misleading market statistics. Data shows transaction deposits are increasing, and bankers breathe a sigh of relief. But 98% of the growth in transaction accounts in 2018 was captured by one bank, Bank of America. The smaller the bank, the far more likely it is that deposit growth failed to keep up with loan growth in 2018, a trend that will continue for the foreseeable future. In fact, in the first quarter of 2019 alone, the industry lost $56 billion of transaction accounts, which nearly erased all the growth seen by the industry in 2018.

Community banks with between $1 billion and $10 billion in total assets are struggling with funding their loan growth. This group saw an incremental loan-to-deposit (LTD) ratio of a troubling 115% percent in 2018.

First quarter 2019 data showed that the least sticky and most expensive form of deposits (CDs) are growing at the expense of the least expensive transaction accounts. CDs are absorbing all the growth in the supply of deposits in the banking system. Community banks under $1 billion in assets shed $2.9 billion in transaction accounts in the first quarter alone.

The smaller the bank, the more likely that deposit growth failed to keep up with loan growth. Nearly every community bank is starting to feel pricing and volume pressures on its deposit base. They are falling back on variations of historical deposit gathering techniques that will only have minimal impact. Organic growth strategies such as rewards programs and pumping up your tellers may help, but if all your peers do the same thing, it will negate the impact.

The only practical solution for those community banks with high LTD ratios is acquisitions. At a minimum, the acquisition of a bank with the right profile provides insurance against a liquidity crisis and can offer new fuel to drive loan growth and earnings while other banks struggle with tapped-out balance sheets.

While there is no panacea for the deposit challenge, affected banks must explore acquisitions. M&A is the one strategy that can significantly alter the balance sheet and the LTD ratio virtually overnight. M&A is an especially effective strategy in an environment in which organic growth is tough, if not impossible. However, while this strategy seems good in theory, there are three practical problems:

1. Most banks with an LTD problem are in growth markets, yet growth markets have few banks with low LTD ratios.

2. Those handful of banks with low LTD ratios are not for sale.

3. Conventional valuation methods (EPS accretion, TBV dilution, etc.) won't work, either because the acquiring bank doesn't have strong enough currency, or the seller (if it exists) wants a valuation that appears excessive relative to recent comparable transactions.

Unprecedented times call for unconventional strategies. And that means community banks should consider out-of-market acquisitions with a focus on lower-growth and rural markets.

This strategy can increase the number of viable targets and create significant financial value for the acquirer because of the potential deposit growth. There is also strategic value since a bank can increase its deposit portfolio and add loans in a new market, helping diversify the loan portfolio from a credit risk perspective. The bank can then deploy excess deposits into its legacy market where deposits are a scarce commodity, essentially optimizing its role as a financial intermediary.

Different analytics are required to value the balance sheet components of a prospective acquisition. The valuation of a target's deposits must capture the ability to replicate such deposits with organic growth (which is just about impossible in this environment), the increase in capacity and impact on profitability to preserve or make loans with those deposits, and the downside protection the target's deposits provide against a deposit drain caused by QE reversal.

Management teams must begin educating directors and shareholders on these challenges. Managers will need to prepare their argument carefully because this strategy is counterintuitive. If the case is laid out properly, most directors and shareholders will recognize how these types of acquisitions can ultimately maximize shareholder value.

Remember: This **unconventional M&A strategy requires a first-mover advantage.** A handful of banks in growth markets are already pursuing this kind of plan. In six to 12 months, expect more banks to follow suit, creating a mad rush to the proverbial rural door. By then, it will be too late, as those low LTD ratio banks willing to sell will have already been picked off. Waiting until the "big fish" in your market announces an out-of-market acquisition to make it easier for you to pursue such a strategy is a mistake.

This type of strategy is where the CEO's courage and leadership come in. Many banks, especially banks in growth markets, are finding themselves at a crossroads. **The urgency to grow deposits is increasing, yet the pie for deposits in the market is either not growing or shrinking. While out-of-market acquisitions might still be a long shot, they must be explored as a potential solution.** »

Adam Mustafa is the CEO and co-founder of the Invictus Group, a data-driven strategic advisory firm that specializes in M&A, stress testing and CECL. Invictus' proactive approach to M&A uses its BankGenome™ intelligence system to create and find deals for its clients. Mustafa has a BA from Syracuse University and an MBA from Georgetown University.

Banking Trends For 2020:
Challenges and Uncertainty Ahead

By Arthur A. Coren, S. Alan Rosen, and Steven J. Sweeney, Duane Morris LLP

In 2020, myriad issues are likely to concern banks, bankers and banking regulators: among them, interest rate sensitivity, regulatory developments, cybersecurity worries, competition and uncertainty. Thoughts on how to navigate these challenges are below.

There is little doubt that regulators will have a renewed focus in 2020 on **interest rate sensitivity,** which could lead to a drain on earnings and regulatory criticism — a double threat to a bank's well-being. On Sept. 18, 2019, the Federal Reserve Open Market Committee announced that it would cut the target interest rate from 2.25% to a range of 1.75% to 2% — a quarter to a half-point reduction. Additional reductions are possible, depending on the economy's performance. Thus, it appears that 2020 may be a year where banks will face a declining interest rate environment. While this may be advantageous to banks whose balance sheets are liability sensitive, bankers should have in focus the lessons of a decade ago regarding regulatory expectations and best practices concerning interest rate sensitivity to market rate risk. Banks must keep interest rate sensitive assets and liabilities balanced, and be mindful of interest rate risk, not only as rates go down, but with an eye toward when they rise again. Bulking up on long-term fixed-rate loans and investments may appear to be a good strategy when rates are in decline; however, bankers should keep in mind potential negative consequences that may follow when rates start climbing again.

Preparation for the implementation of currently expected **credit loss accounting, or "CECL,"** will continue in 2020. CECL requires banks to book appropriate reserves at the inception of a loan, based on predictive models for loan losses, and to update the loan loss reserve periodically. SEC filers are required to comply in 2020. Even though non-SEC filing entities are not required to implement CECL until after 2020, and an entity that is neither an SEC filer nor a Public Business Entity is not required to implement CECL until 2022, banks that have not already done so should be acting in 2020 to transition to CECL accounting.

Some bankers are wary of CECL's pro-cyclical effects. If the economy weakens in 2020 or soon thereafter, it is natural for earnings to be compressed. At the same time, a bank will need to **reevaluate its ALLL reserve**. In a weaker economic environment, a bank will need to account for an increased likelihood of defaults and recognize even heftier reserves against its loan portfolios. Thus, in a sense, earnings may get hit twice. Banks must keep this in mind as they revisit their strategic and capital planning in the coming year; this is especially true in light of fears that a recession may be on the horizon.

An area that will continue to keep bankers awake at night in 2020 is **Bank Secrecy Act compliance.** BSA continues to remain a top priority for banking regulators, and they continue to have a zero-tolerance policy when it comes to BSA violations. Banks need to keep their BSA/anti-money laundering compliance efforts in "tip-top" shape, as any lapse may severely impact a bank's business strategy — whether it is new branch openings, acquisitions, new business units or other plans that may be put on hold if a bank becomes subject to a formal or informal BSA order. A bank's investment in systems, training, and personnel in this area is expected to continue at a robust pace, as financial institutions remain the first line of defense in the government's AML early detection system.

Cyber-attack risk is likely to grow in 2020 and remain at the forefront of concern for bankers and regulators. One successful attack can have devastating repercussions on a bank's reputation, customer relations and bottom line. Those focused on this issue say it is not whether a bank will be a victim of a cyber-attack, but when, and how quickly it can be detected and remediated. Banks need to stay actively involved to protect against unauthorized access to databases and bank accounts, phishing fraud and falsified know-your-customer documentation. We recommend continuing to invest in monitoring cyber risks and in testing, development and implementing detection systems. We also encourage banks to employ regular education and sensitizing of staff, use current dual-factor authentication and single-use password systems. Banks must regularly review their action plans in preparation for cyber-attacks.

Banks will also need to continue to remain **competitive** in an increasingly competitive environment in 2020; this is truer than ever, as banks face more and more non-bank competitors, such as fintech and other non-bank lenders and service providers. Financial technology companies likely will continue to challenge the current method of operations as a disruptor in 2020. Banks should continue to offer state-of-the-art products and services, so they do not lag. As customers continue to expect significantly quicker responses to credit requests and cutting-edge digital banking services, and as the competition for the customer increases, banks will continue to need to develop, adopt and implement faster lending approval processes to meet the demand, altering older systems in favor of more innovative processes that may include customer learning and other cognitive technologies. While fintechs have often been considered competition, 2020 should see more partnerships and strategic collaboration between banks — particularly community banks — with fintechs affording them access to the technological innovations necessary to attract, satisfy and keep customers, while affording fintechs access to the knowledge, experience, personnel, and structure often absent from their businesses.

Banking of hemp-related businesses remains at the forefront. Since the Farm Bill was enacted on Dec. 20, 2018, industrial hemp was removed from the definition of "marijuana." As a result, industrial hemp, containing less than 0.3% tetrahydrocannabinol, or "THC," is no longer a controlled substance and is legal. Thus, previous federal restrictions applicable to hemp no longer apply. It may seem that banks now have a "green light" to bank hemp-related businesses, such as hemp-derived cannabidiol, or CBD. However, despite this development,

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> Due to the many restrictions and uncertainties related to cannabis-derived hemp, banks should continue to proceed carefully before banking hemp-related businesses. Banks should consider treating hemp-related businesses similar to how they should treat a marijuana-related business, or "MRB"; this includes assigning a high-risk rating to any hemp-related business, scrutinizing the customer — and its customers, and monitoring the ongoing business being conducted — just as a bank would monitor any other high-risk business.

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banks should proceed carefully before banking hemp-related businesses, because many federal and state restrictions still apply to hemp products such as CBD. Indeed, any cannabis or hemp product marketed with a claim of therapeutic benefit or disease prevention must be approved by the FDA before being introduced into interstate commerce. Further, the FDA takes the position that introducing food or dietary supplements with added CBD or THC is illegal under the Federal Food, Drug, and Cosmetic Act. Many states have restrictions concerning CBD and other hemp-derived products.

While the FDIC has acknowledged that hemp is now legal and that banks are no longer required to file marijuana-related suspicious activity reports on hemp-related businesses, the FDIC has not issued any formal guidance on hemp. FDIC Chairman Jelena McWilliams has stated that financial providers should not decline to provide banking services to entire categories of customers but, rather, should "assess risk on a case-by-case basis."

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State legislatures appear to be considering **enhanced consumer protection legislation and corresponding regulation** for 2020. Some states, such as New York and New Jersey, already have enhanced consumer financial protections. California is considering following suit by increasing its department of business oversight consumer protection staff. The bill's proponents believe that the federal Consumer Financial Protection Bureau has weakened under the current administration and consumer financial protections along with it; this would continue a trend in state-level consumer protections, such as California's Student Loan Servicing Act (which became law in 2017) and similar state laws. Many banks believe financial institutions face enough regulation already — including in the consumer finance arena — and that more regulation is unnecessary and will be overly burdensome.

Banks and their boards of directors must continue to address, in a meaningful way, **succession planning and diversity and inclusion** in their board and management structures. Bank regulators have seriously supported both elements. Moreover, for financial institutions to have the best chance of serving their customer base in an enlightened and responsive manner, implanting these elements is essential.

Finally, remember there is a presidential election in 2020 — with a potentially massive impact on banks. If the incumbent is reelected, the trend toward less regulation would likely continue. If, however, the incumbent's opposition wins and takes control, a move toward greater regulation is likely, and federal tax law adjustments could follow. While banks will ply their course regardless of the outcome, the impact could be great, and this is certainly something we will all keep an eye on as we move into, and throughout, 2020 and beyond. »

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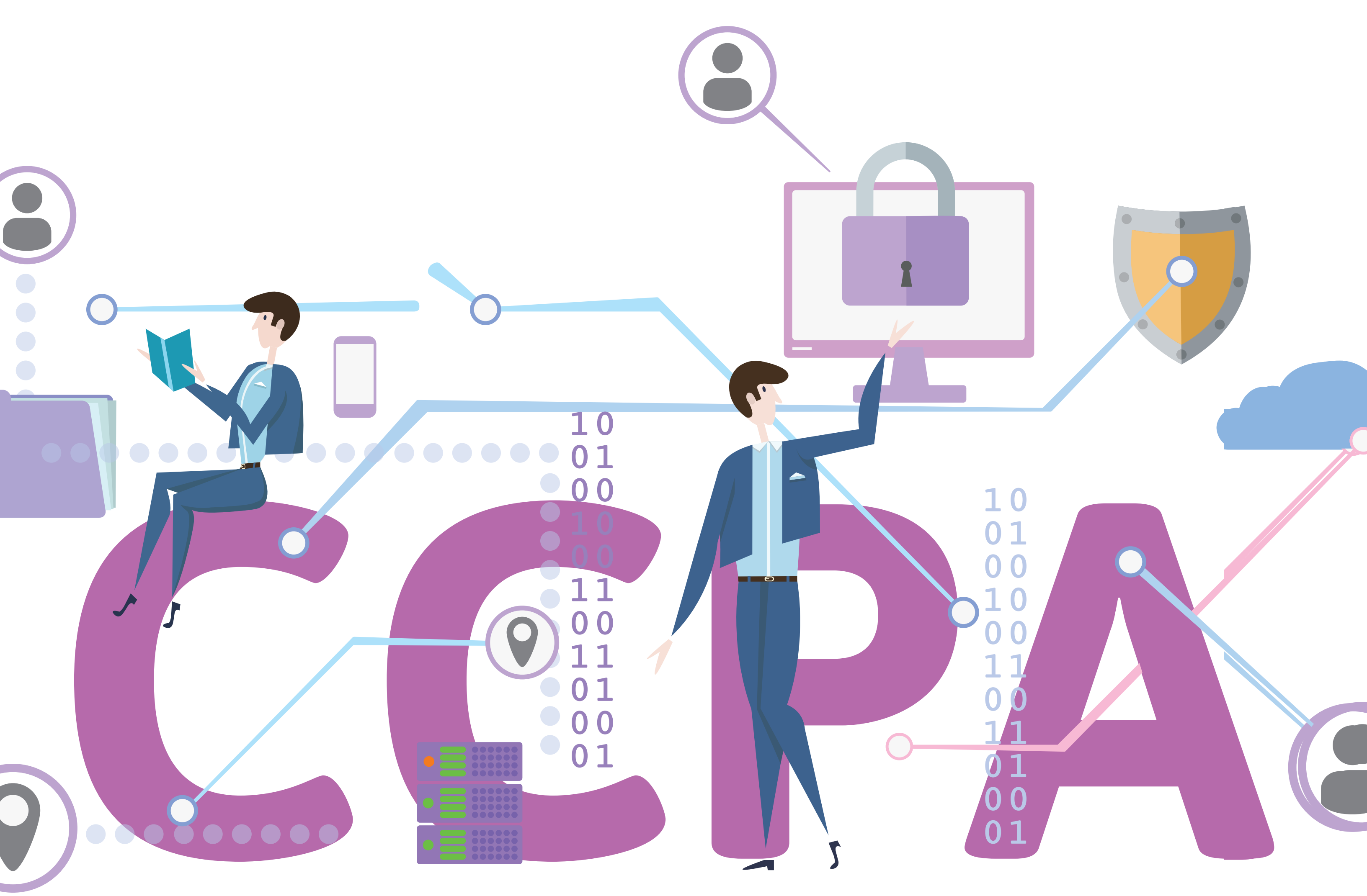

The West Coast Policy Incubator

By Kevin Gould, SVP, Director of Government Relations, California Bankers Association

It has long been the case that what happens in California, legislatively, tends to spread across the country. There are numerous examples where the state has been a catalyst for legislation introduced in other states and has prompted discussions at the federal level. But California is not alone in this policy incubator phenomenon. California, Oregon, and Washington specialize in advancing progressive ideas. We have witnessed this more recently with privacy. While much of the motivation by policymakers is a reaction to developments in the technology industry, the legislative response tends to be less precise and spills over other business segments.

Case in point, in 2018, the California Legislature passed the most comprehensive privacy law in the United States known as the California Consumer Privacy Act (CCPA). Among other provisions, the CCPA establishes consumer rights: 1) to know the personal information a business collects on them; 2) to delete their personal information; 3) to prevent sale of their personal information and; 4) to be free of discrimination in the offering and pricing of services based on the consumer's exercising these rights. The law also provides a private right of action when a consumer's nonencrypted and nonredacted personal information is subject to unauthorized access and ex-filtration, theft, or disclosure as a result of a business's failure to maintain reasonable security procedures.

And even though policymakers knew the CCPA needed further refinements, including finalization of rulemaking that remains pending, we knew the action taken by California would result in various states attempting to model the CCPA. An example of this is pending legislation in Washington. Discussions with stakeholders began in late 2018 following the enactment of CCPA. However, the effort quickly bogged down due to competing interests and disagreements on how far the policy should go. Neither side could reach consensus on solving major policy issues such as the use of facial recognition technology and creating a private right of action for violations, causing these initial efforts to stall.

Washington lawmakers have reintroduced two measures this year. Legislation passed from the Senate (SB 6281) contains a GLBA data exemption and is now in the House for consideration. A companion House bill (HB 2742) passed from the policy committee but ultimately died due to substantive amendments that included a private right of action opposed by the business community. It is anticipated that the onerous language from the House measure will be forced into the Senate bill; this may cause lawmakers to finish the year without enacting CCPA-like privacy legislation with the debate continuing next year.

And in Oregon, the topic of facial recognition regulation is rearing its head. While the Oregon Legislature has not taken up the subject so far, the city of Portland is exploring whether to regulate its use. Proposed ordinance language has not been made public, and discussions with stakeholders are ongoing. The city appears to be looking to solve three broad issues: first, whether there should be regulation on facial recognition technology in public spaces; second, what regulation or limitations, if any, should be put in place for facial recognition technology used on private property, including commercial property; and, third, whether there should be regulation on the use of data derived from facial recognition technology. While the timeline for adopting a plan has not been determined, it is possible that an ordinance could be in place later in the spring or early summer.

Even in more conservative states, like Arizona, two measures are pending that bear significant resemblance to the CCPA. While the legislation is not expected to pass, it is further evidence that what happens in California doesn't typically stay in California.

For banks that operate in different parts of the country, what happens on the West Coast matters. So, what other public policy issues under discussion in California might spread? Last year, the governor signed a measure allowing municipalities to establish a public bank under the false narrative that private sector banks were misaligned with the value of their communities. We know that public banking advocates will take their success in California and attempt to export it to other states.

This January, Governor Gavin Newsom unveiled plans to restructure the regulatory agency that oversees California state-chartered financial institutions. Under the plan, the California Department of Business Oversight (DBO) will be renamed as the Department of Financial Protection and

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Innovation (DFPI) and will increase its emphasis on consumer protection and innovation relative to financial technology and products. These reforms are being advanced, in part, given concerns about a shift in priorities at the federal level, a desire for the state to demonstrate ongoing leadership, and an interest in fostering innovation and establishing the appropriate controls for providers of financial services.

According to preliminary information provided by the DBO, the purpose of this proposal is to 1) restore financial protections that have been paralyzed at the federal level; 2) protect consumers from predatory businesses, without imposing undue burdens on honest and fair operators; 3) spur — not stifle — innovation in financial services by clarifying regulatory expectations for emerging products and services; 4) extend state oversight to important financial-services providers not currently subject to state supervision; 5) increase public outreach and education, especially for vulnerable populations; and 6) provide more effective response to consumer complaints.

Should the plan to restructure DBO be successful, we anticipate other states will follow. California relishes and takes great pride in its role as a legislative pioneer. As the legislative year in California unfolds, we'll have a better sense of public policy issues that may catch fire elsewhere. »

Kevin Gould is the senior vice president and director of government relations for the California Bankers Association. He joined the CBA in 2004, bringing with him more than seven years of legislative experience. In his role, he oversees the management and operation of CBA's state and federal government relations department and serves as one of CBA's three registered lobbyists. Kevin's advocacy responsibilities and issues focus mainly in the areas of bank operations, commercial lending, residential property lending, and wealth and asset management issues.

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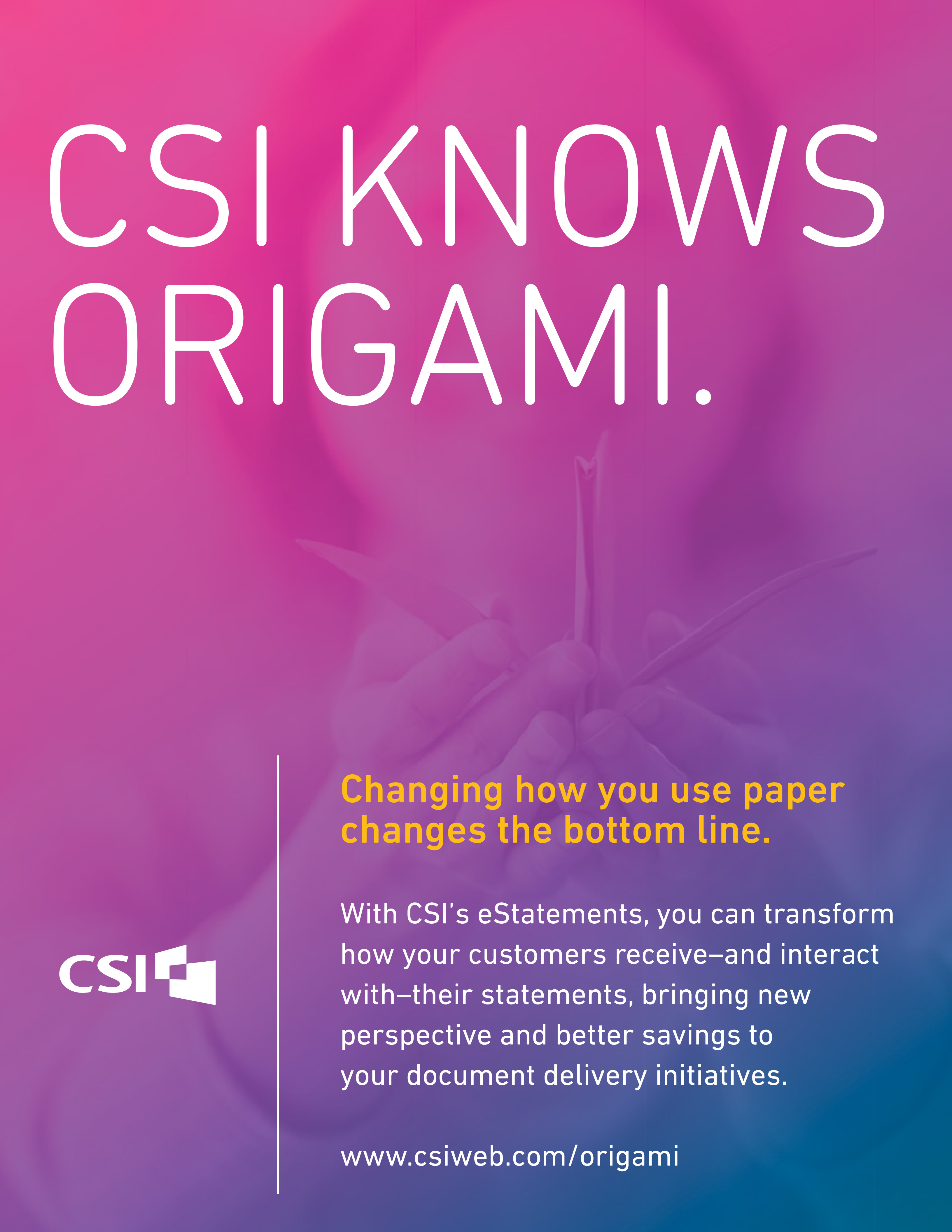
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