# Supervisory Insights

Devoted to Advancing the Practice of Bank Supervision

Vol. 14, Issue 1 Summer 2017

## Inside



FDIC

## Supervisory Insights

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# Issue at a Glance

Volume 14, Issue 1 Summer 2017



## Articles



FDIC examiners recently have observed liquidity stress at a small number of banks. Although these have been isolated instances, they illustrate the importance of liquidity risk management as many institutions continue to reduce holdings of liquid assets. Bank management should be cognizant of potential funding issues that can arise in stress situations as they develop or revise contingency funding plans. The article reiterates principles outlined in existing supervisory guidance and is intended as a resource for bankers who wish to heighten awareness of prudent liquidity and funds management.



The information collected through Bank Secrecy Act/Anti-Money Laundering (BSA/AML) programs is critical to the United States government's counter terrorist financing initiatives and other longstanding efforts to protect the financial system from illicit finance. The FDIC carefully evaluates a depository institution's compliance with the recordkeeping and reporting requirements of the BSA and implementing AML regulations. The focus of the BSA/AML examination is to assess whether the depository institution has established appropriate policies, procedures, and processes consistent with the institution's BSA/AML risk. The article reports that the vast majority of BSA/AML compliance deficiencies identified by the FDIC are resolved through the supervisory process without the need for an enforcement action. The article also provides examples of rare, but significant, failures in BSA/AML compliance programs.

## Regular Features



This feature provides an overview of recently released regulations and supervisory guidance.

# Letter from the Director

The FDIC strives to make information available to our readers to help them navigate changes in laws, regulations, and the economic climate. This issue of *Supervisory Insights* focuses on recent trends in liquidity risk management and compliance with the *Bank Secrecy Act* (BSA).

The FDIC has observed an increase in the use of non-core and wholesale funding sources and a decrease in holdings of liquid assets at a number of the institutions we supervise. At a few institutions, asset quality problems have resulted in significant liquidity stress. Although such situations have been infrequent, they illustrate the importance of effective management of liquidity risk. "Community Bank Liquidity Risk: Trends and Observations from Recent Examinations" discusses the process for developing liquidity risk management policies and procedures that are tailored to the risk profile of the bank, and emphasizes the importance of planning for high-impact, unexpected liquidity events. The article features a guide for developing and reviewing a bank's contingency funding plan.

FDIC examiners are receiving questions from bankers about compliance with the BSA. "The Bank Secrecy Act: A Supervisory Update" describes the purpose, development, and changes to the BSA over the years. The article provides an overview of the examination process and includes information on recent trends in BSA examination findings. The article notes that the majority of FDIC-supervised institutions have in place adequate systems of BSA-related internal controls, and that when compliance deficiencies are identified, they are resolved in the vast majority of instances through the supervisory process in the normal course, without the need for a formal enforcement action. The article also provides examples of rare, but significant, failures in BSA/AML compliance programs.

This issue of *Supervisory Insights* also includes our regular summary of recently released regulations and supervisory guidance.

We hope you read both articles in this issue and find the information useful. We encourage our readers to provide feedback and suggest topics for future issues. Please email your comments and suggestions to SupervisoryJournal@fdic.gov

**Doreen R. Eberley**
*Director*
*Division of Risk Management Supervision*

# Community Bank Liquidity Risk: Trends and Observations from Recent Examinations

## Introduction

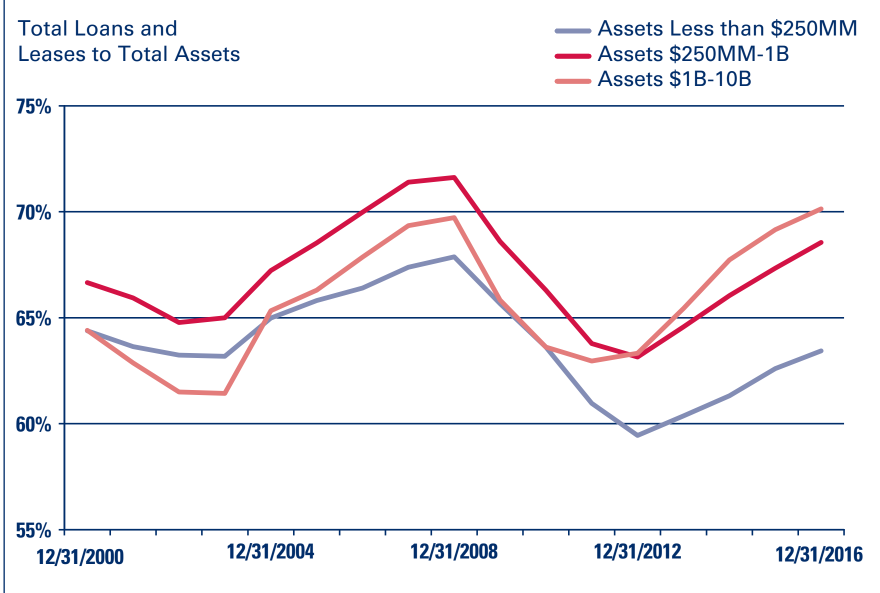
The FDIC recently has observed instances of liquidity stress at a small number of insured banks.[1] Although these have been isolated instances, they illustrate the importance of liquidity risk management as many banks continue to increase lending and reduce their holdings of liquid assets. It is important for bankers to be aware of funding issues that can arise in stress situations, especially as they develop or review their contingency funding plans (CFPs). This article is intended as a resource for bankers who wish to heighten awareness of such issues and should not be viewed as supervisory guidance or required reading.

The article begins with a broad overview of trends in smaller banks' (those with less than $10 billion in assets) balance sheets, which suggest that as the current business cycle progresses, liquidity risk is generally increasing for these institutions as a group. This is followed by a more detailed discussion of a number of specific funding issues that can give rise to liquidity stress, especially for institutions experiencing credit quality issues or more watchful counterparties seeking higher collateral and terms to protect their exposure. The article concludes with a discussion of the use of contingency funding plans and cash flow projections by bankers to help determine the size of their liquidity cushions and to otherwise plan for future success.

## Trends in Liquidity Risk - Overview

Bank loan growth has picked up considerably in recent years. Chart 1 illustrates that following the steady loan run-off and slowdown in originations since the financial crisis, the ratio of total loans to total assets has rebounded sharply since 2012 for institutions with less than $10 billion in assets.

**Chart 1: Total Loans and Leases on the Rise after Retreating Post-Crisis**



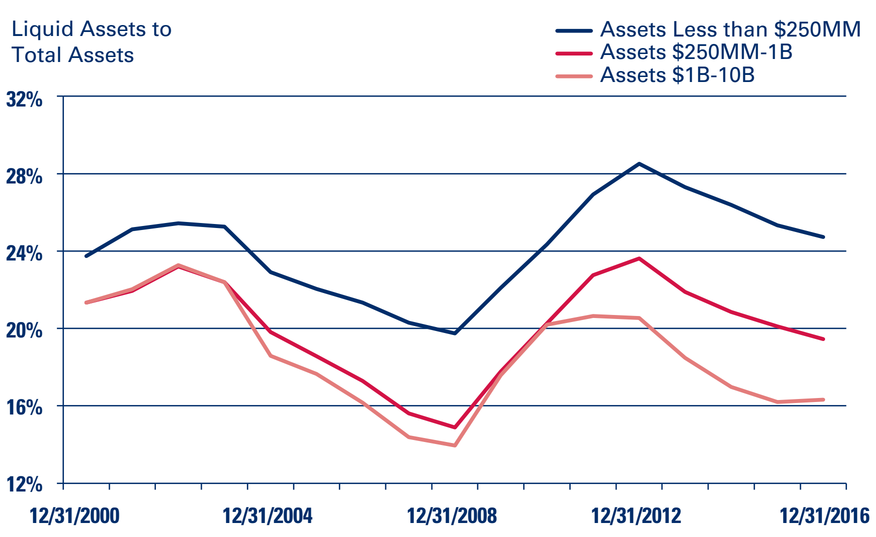

Source: Call Report Data

[1] Throughout this article, the word "bank" is used synonymously and interchangeably with the words "insured depository institution," unless the context requires or suggests otherwise.

# Community Bank Liquidity Risk

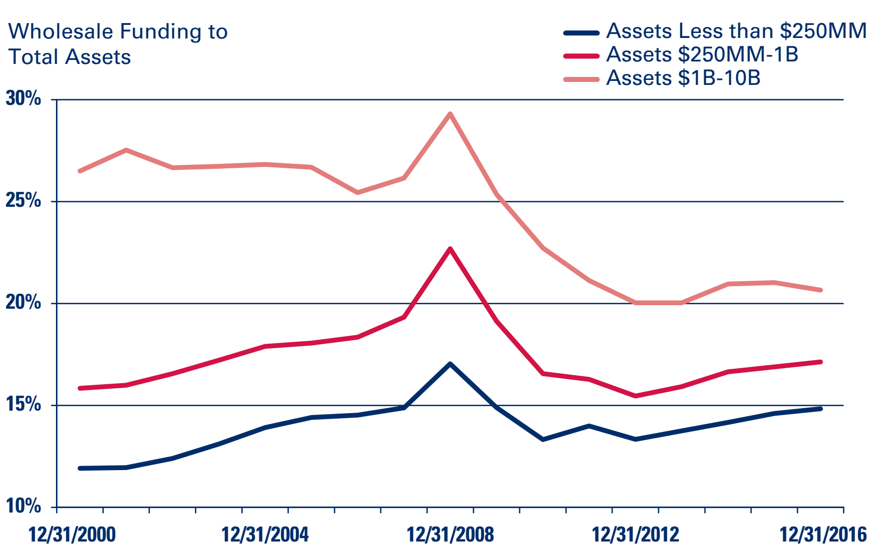
continued from pg. 3

**Chart 2: Liquid Assets Rebound then Retreat Post-Crisis**




Source: Call Report Data
Liquid Asset Proxy: Cash, Federal funds sold, Reverse Repos, and Unpledged Held-to-Maturity (HTM) and Available-for-Sale (AFS) Securities

**Chart 3: Wholesale Funding to Total Assets**




Source: Call Report Data
Wholesale Funding: Brokered, Listing Service, Foreign, and Public Deposits; FFP; Repos; and Borrowings

Loan growth has been accompanied by a decrease in liquid asset holdings. Further, a number of community banks have increased reliance on non-core and wholesale sources[2] to fund loan growth. Charts 2 and 3 illustrate trends in liquid assets and wholesale funding since 2001.

While many well-managed institutions have successfully integrated non-core or wholesale sources and borrowings as a component of their liquidity and funding strategy, some have used these funding sources in concentrated amounts as part of aggressive loan growth or other leverage strategies. Although these sources can be part of a well-managed funding strategy, they may also be problematic when institutions overly rely upon them. For example, during periods of financial stress, many of these funding sources are subject to counterparty requirements and certain legal and regulatory restrictions, especially if capital levels deteriorate. The declining liquid asset cushions and increased use of potentially non-stable liquidity sources depicted respectively in Charts 2 and 3 suggest that small banks as a group are increasing their liquidity risk profiles as the current business cycle progresses.

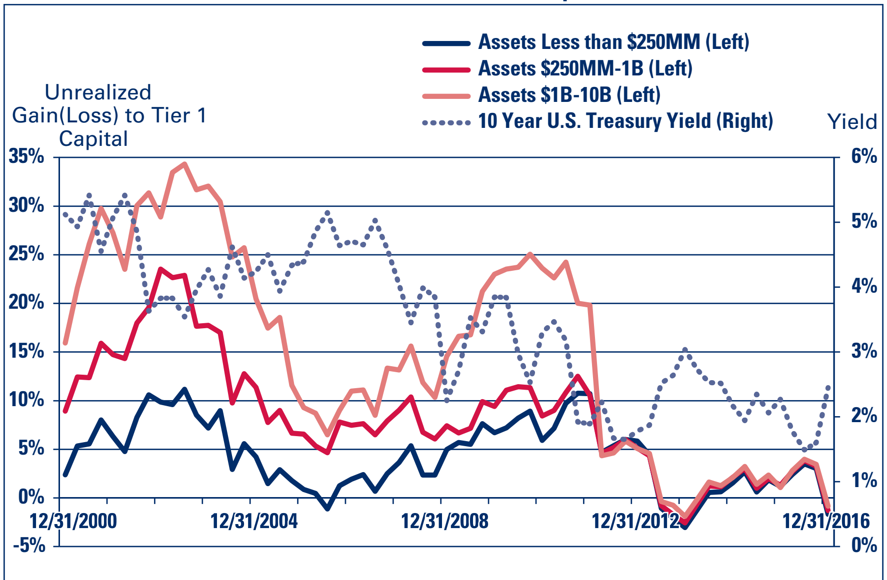
[2] Non-core funding may include, but is not limited to, borrowed money such as Federal Home Loan Bank (FHLB) advances, short-term correspondent loans, and other credit facilities, as well as brokered certificates of deposit (CDs) and CDs larger than $250,000. Wholesale funding includes, but is not limited to, brokered deposits, Internet deposits, deposits obtained through listing services, foreign deposits, public funds, Federal funds purchased (FFP), FHLB advances, correspondent credit lines, and other borrowings. High-rate and uninsured deposit accounts are also potentially volatile in certain cases and may have characteristics similar to non-core or wholesale funding. These potentially volatile funding sources are addressed in the *FDIC Manual of Examination Policies*, Section 6.1 - Liquidity and Funds Management, Pages 8-17. See www.fdic.gov/regulations/safety/manual/section6-1.pdf.

## *Unencumbered Liquid Assets - A Pillar of Strength in Crisis*

Based on the FDIC's experience, the first line of defense for responding to a liquidity event is a cushion of unencumbered liquid assets (i.e., assets free from legal, regulatory, or operational impediments). A number of recent cases indicate that an insufficient level of unencumbered liquid assets can compound liquidity troubles. As illustrated in Chart 2, overall trends indicate that some community banks are experiencing a drop in liquid asset levels.

In a stress scenario, accessibility of liquid assets is important. It is typically easier for an institution to sell a readily marketable security or withdraw a Federal Reserve district bank deposit than to request an advance from a funds provider that may be aware of an institution's financial problems and worrying about the volume of pledged collateral. The most marketable and liquid assets typically consist of U.S. Treasury and agency securities, short-term, investment-quality, money-market instruments, and Federal Reserve or correspondent deposits. These highly liquid, on-balance sheet resources can generally be sold or pledged at little or no discount and serve as a banking institution's lifeblood in a crisis situation. The liquid asset pool is most useful when the assets are free of encumbrance, meaning no party has collateral or other claim at present or on a standby/contingent basis.

**Chart 4: Unrealized Securities Gains (Losses) to Tier 1 Capital**




Source: Call Report Data, HTM and AFS securities

Additionally, when considering availability of the liquid asset pool, it is important to recognize potential market risk in the fixed-income portfolio. As interest rates increase, the price of fixed-income instruments tends to decline. In the current rising rate environment, unrealized depreciation in the liquid asset pool could result in a loss of principal if the securities are sold, further constraining on-balance sheet resources. Chart 4 illustrates the long-term declining trend in unrealized gain and loss positions of held-to-maturity and available-for-sale securities. Even if a bank's investment portfolio consists of very liquid, unencumbered securities, factors such as the interest rate environment could result in realized losses if securities are liquidated. Unrealized losses in such portfolios would lead to lower collateral amounts available to secure future borrowings.

# Community Bank Liquidity Risk

continued from pg. 5

**Financial Institutions have Increased Municipal Bond Holdings Post-Crisis**

While community bank liquid assets have gradually contracted, holdings of municipal bonds have increased. As of December 31, 2016, nearly a quarter of all insured financial institutions (1,455) had municipal bond holdings that exceeded 100 percent of tier 1 capital. Prior to the crisis, at December 31, 2007, only 10 percent of insured financial institutions had this level of municipal bond holdings relative to capital. Banks have increasingly invested capital in municipals for several reasons, including that they generally have comparatively low historical default rates, carry attractive tax-free yields, and provide a desirable means to support local, county, and state authorities.

Although municipal bonds are included in the investment portfolio and can be liquidated or used for collateral, they are generally less liquid than U.S. government and agency-guaranteed securities. Some factors that influence the liquidity profile of municipal bonds include:

- The long duration of many municipal bonds, which exposes banks to potential depreciation in a rising rate environment;
- The large number (thousands) of municipal bond issuers, all with different credit characteristics, purposes, and repayment sources;
- The long-term "buy and hold" view of retail and institutional investors (like banks), with relatively few bonds trading daily;
- The difficulty of conducting credit analysis with respect to certain issuers, and the sometimes stale and hard-to-find nature of financial information; and
- The uncommon use of municipal bonds as collateral for repurchase agreements, resulting in generally higher collateral haircuts than those for federally guaranteed securities.

Some of these characteristics are addressed in an FDIC informational video on municipal bond credit analysis that can be found at https://www.fdic.gov/regulations/resources/director/technical/municipal.html.

## *Liability and Funding Considerations*

A "core" customer deposit base serves as the primary funding source for most community financial institutions. These deposits are generally stable, lower-cost, and tend to re-price in a more favorable manner than other instruments when bank-specific conditions or market conditions change. However, when core deposits are unavailable or are not preferred in a funds management strategy, some financial institutions turn to funding from non-core or wholesale sources.

For purposes of this discussion of liquidity risk, the terms non-core and wholesale funding sources refer to funding sources other than insured core deposits. Such funding sources are typically more expensive and less stable than insured core deposits. Further, these funding sources may be difficult or more costly to replace, especially if the institution becomes less than well capitalized and subject to certain legal restrictions detailed later. Non-core and wholesale funding sources may include borrowings, as well as brokered, listing service,[3] Internet, and uninsured deposits. These deposit categories are not mutually exclusive, and this article will not address the regulations and legal interpretations addressing when a deposit is or is not brokered.

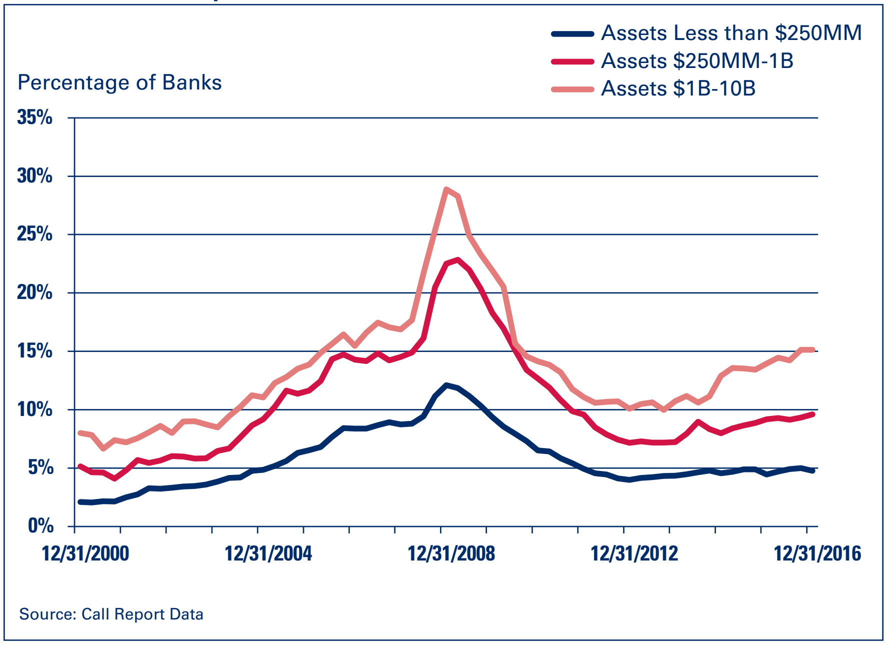
In some recent instances, institutions that had concentrated positions in less stable funding sources have experienced liquidity stress. Weak contingency funding planning and cash flow forecasting also contributed to liquidity strain, leaving some institutions unable to effectively respond to the funding crisis at hand. Some of these potentially volatile funding sources and their risks are described later to illustrate recent developments. The information is not intended to represent any negative views toward these funding sources. Many banks use these sources successfully as part of a prudent asset-liability management program marked by strong risk management, monitoring, and controls. Thus, the information later is based on recent observations and should be viewed as "lessons learned" from recent experiences. Further, the descriptions contain footnotes to applicable rules and guidelines, and readers should not construe the discussion as supervisory guidance.

[3] Note that Section 29 of the Federal Deposit Insurance Act does not exclude "listing services" from the definition of "deposit broker." 12 U.S.C. §1831f. Staff has previously opined that deposits gathered from "passive" listing services may not be considered brokered deposits. *See* FDIC Advisory Op. 04-04 (July 28, 2004). However, if the listing service places deposits or facilitates the placement of deposits (in addition to compiling and publishing information on interest rates and other features of deposit accounts), the listing service is a deposit broker, and the deposits should be reported as brokered deposits.

# Community Bank Liquidity Risk

continued from pg. 7

**Chart 5: Brokered Deposits Greater than 10% of Total Assets**




## Brokered Deposits

A brokered deposit is generally a deposit obtained, directly or indirectly, from or through a deposit broker.[4] Brokered deposits can complement core deposits and other sources as part of a comprehensive funding program. However, the FDIC has observed that rapid asset growth funded by brokered deposits has been directly associated with a higher incidence of problem banks and failures.[5] The proportion of banks materially utilizing the brokered deposit market as a funding source has been trending slightly higher for the past several years, as indicated by Chart 5. Brokered deposits can be more rate sensitive than other funding sources and have substantial run-off risk after maturity if competitive interest rates are not offered. Further, if the bank falls below well capitalized, brokered deposit restrictions, as well as interest rate restrictions on all the bank's deposits, can severely limit the bank's ability to access, retain, or rollover deposits.

[4] Section 29 of the FDI Act (Section 29) defines the term "deposit broker" as (A) any person engaged in the business of placing deposits, or facilitating the placement of deposits, of third parties with insured depository institutions or the business of placing deposits with insured depository institutions for the purpose of selling interests in those deposits to third parties; and (B) an agent or trustee who establishes a deposit account to facilitate a business arrangement with an insured depository institution to use the proceeds of the account to fund a prearranged loan. See 12 U.S.C. § 1831f.

[5] "On average, institutions that use brokered deposits typically use lower shares of core deposit funds than institutions that do not, and, as a result, they face a higher probability of default. The FDIC's statistical analyses also show that brokered deposits are an indicator of higher risk appetite. Banks that use brokered deposits have higher growth and higher subsequent nonperforming loan ratios, which are both associated with a higher probability of failure." See *FDIC's Study on Core Deposits and Brokered Deposits*, Page 47, July 8, 2011, www.fdic.gov/regulations/reform/coredeposit-study.pdf.

## Restrictions on Brokered Deposits and Interest Rates Paid on All Deposits

**Restrictions under Section 29 of the Federal Deposit Insurance Act (FDI Act) -Brokered Deposits:** Brokered deposits are readily obtainable when a financial institution is profitable and well capitalized under the Prompt Corrective Action (PCA) capital regulation. Under Section 29 of the FDI Act, a well-capitalized insured depository institution may accept, renew, or roll over brokered deposits without restriction. However, when an institution is notified that its capital category is less than well capitalized, Section 29 restricts the use of brokered deposits. More specifically, an adequately capitalized insured depository institution may not accept, renew, or roll over any brokered deposit unless the institution has applied for, and has been granted a waiver by, the FDIC. Further, the brokered deposit restrictions under Section 29 prohibit an undercapitalized insured depository institution from accepting, renewing, or rolling over any brokered deposits.

**Restrictions under Section 29 of the FDI Act – Interest Rates Paid on Deposits:** Separate from the brokered deposit restrictions, Section 29 restricts a bank that is not well capitalized from offering interest rates on any of its deposits significantly higher than the prevailing rates in a particular market. Generally, under the FDIC's regulations,[6] a bank that is not well capitalized may not offer deposit rates more than 75 basis points above average national rates (or a prevailing local market rate as applicable) for any deposits of similar size and maturity.[7] It is important for banks to be well aware of applicable interest rate caps in the event the institution's capital levels were to fall below well capitalized. The FDIC cannot waive the interest rate restrictions.

These provisions of the FDI Act were a response to the banking and savings and loan crises of the 1980s and early 1990s. Nonviable depository institutions had been allowed to remain open for long periods of time by relying on the federal deposit insurance guarantee to continue to attract brokered and high-cost deposits, deepening their losses and the ultimate cost to the insurance funds. These FDI Act provisions increase the impetus for bankers and regulators to take corrective measures to confront issues at troubled institutions as capital becomes depleted.[8]

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[6] Section 337.6 of the FDIC Rules and Regulations (12 CFR 337.6(b)) "Brokered Deposits" is available at www.fdic.gov/regulations/laws/rules/2000-5900.html. As a resource, in 2015, the FDIC published a set of Frequently Asked Questions (FAQs) on brokered deposits as a plain language summary of previously issued guidance. In June 2016, the FDIC finalized updates to the FAQs in FIL-42-16, *Frequently Asked Questions on Identifying, Accepting, and Reporting Brokered Deposits*, June 30, 2016, www.fdic.gov/news/news/financial/2016/fil16042.html.

[7] An institution subject to interest rate restrictions under Section 29 of the FDI Act and its implementing regulations (12 CFR 337.6) is required to use the "national rate" to determine conformance with the restrictions unless it has been granted a determination that it is operating in a high-rate area. In that event, "local deposit rates must not significantly exceed (no more than 75 basis points) the prevailing rate cap for the institution's market area." See FIL-69-09, *Process for Determining If An Institution Subject to Interest-Rate Restrictions is Operating in a High-Rate Area*, December 4, 2009, www.fdic.gov/news/news/financial/2009/fil09069.html. The national rate is a simple average of rates paid by all banks and branches for a variety of deposit products in a number of maturity categories. National rate caps are posted by the FDIC weekly at https://www.fdic.gov/regulations/resources/rates/.

[8] See *FDIC's Study on Core Deposits and Brokered Deposits*, Page 3 July 8, 2011.

continued from pg. 9

The restriction on the use of brokered deposits, and the separate restriction on the interest rates paid on deposits more generally, are triggered when a bank becomes less than well capitalized under the PCA capital regulations. This typically is the result of significant asset quality or earnings deterioration. As such, these two restrictions are often triggered at the same time other funding counterparties reduce credit or demand higher collateral margins. Banks in this situation can find it difficult and costly to replace deposit run-off with other funding while their institution is subject to stress. This can lead to a liquidity squeeze, forcing management to scramble to identify alternative funding.

### Listing Service Deposits

Banks obtain deposits from listing services by posting interest rates with a listing service marketplace to attract funds from the national deposit market. This is a relatively easy process as funds can be attracted quickly by offering competitive deposit rates. Listing service deposits and brokered deposits are not mutually exclusive categories: a listing service deposit may or may not be a brokered deposit depending on the features of the program. For purposes of liquidity risk management, however, bank management needs to be aware that funds gathered from listing services can have rate sensitivity characteristics similar to other non-core deposits because they often involve customers who have no other relationship with the institution and solely are seeking to maximize return.

Over the years, many banks have used listing service deposits in a safe-and-sound manner, but some have relied heavily on listing service deposits without proper risk-management monitoring and controls. If a bank's financial condition and PCA capital category deteriorated, listing service deposits may be difficult to obtain. For example, if competitive rates are above the national rate cap, the bank may not be able to attract its desired amount of funds. Notably, deposit rates reported by some listing services since early 2016 have been above the national rate cap for certificates of deposit of various maturities.

### Other Potentially Rate-Sensitive Deposits

The national rate cap (or prevailing rate as applicable) would apply to other potentially interest-rate sensitive deposits when a bank falls below the well-capitalized PCA category. Examples may include Internet deposits, or CDs or other locally gathered deposits that banks attracted primarily by the offer of higher interest rates. Such deposits could be more interest-rate sensitive, resulting in net interest margin pressure during a rising rate environment. In the event an institution becomes less than well capitalized, interest rate restrictions may create significant replacement funding and other challenges. Consequently, risk-management processes applicable to brokered and listing service deposits generally apply to other potentially interest-rate sensitive deposits as well.

### Uninsured Deposits

For a variety of business or economic reasons, depositors may place funds in financial institutions in an amount that exceeds federal deposit insurance limits. When an institution is in strong financial condition, uninsured depositors may behave similarly to insured depositors as a result of a bank's perceived safety. However, if an institution encounters financial stress or negative public attention, uninsured depositors could make significant withdrawals.

## Standby Credit Facilities Supporting Uninsured Public Deposits

States, counties, and other municipal authorities place deposits in insured depository institutions to safeguard public funds, access payment systems, and produce a reasonable yield. According to state law in many jurisdictions, these deposits must be fully protected by deposit insurance; a pledge of obligations issued by the U.S. Treasury, U.S. government agencies, or state and local governments; or standby letters of credit (SBLC), issued by a Federal Home Loan Bank (FHLB). Some financial institutions favor the use of FHLB SBLC over the pledge of bank-owned securities as part of a liability-based liquidity strategy. This practice is not without risk. FHLB SBLC encumber assets at the time of commitment through the life of the instrument. As a result, the assets pledged are unavailable for conversion to cash or to use as collateral, and any deterioration in the underlying assets or in the institution's condition may result in a call from the FHLB to post more collateral to secure the SBLC. This would likely occur when the institution has the greatest need for liquidity; this possibility should be fully considered in a bank's CFP.

Furthermore, marshaling funds to cover a public deposit withdrawal could be difficult in a stress event as loans pledged against a SBLC may be more difficult to convert to cash than securities. If the public deposits are withdrawn, replacing them with borrowings (secured by the same collateral that was previously securing the SBLC) could also become more onerous if the institution has become troubled.

FDIC supervisory staff does not discourage the use of such FHLB SBLC facilities, and many institutions have used the products effectively, without adverse liquidity implications. Strong risk managers are familiar with the collateral implications and consider it in their stress scenario and contingency scenario planning.

*Note: SBLC to secure public deposits should be listed in the Call Report RC – L Contingent Liabilities, under item 9 (2) if the amount is 25% or more of tier 1 capital.*

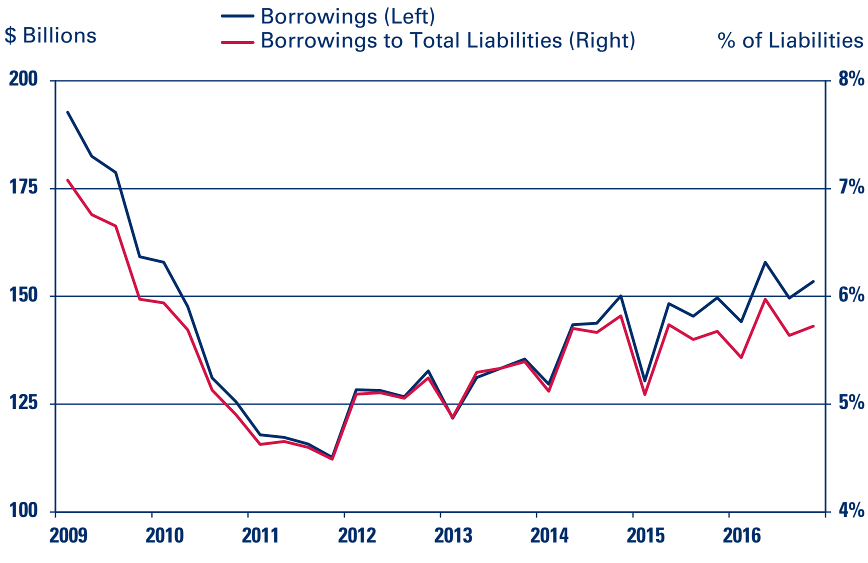
## Borrowings - A Supplemental Wholesale Funding Source

Community banks frequently use borrowings to supplement deposit gathering efforts. Borrowings, which include Federal funds purchases, FHLB advances, repurchase agreements, and other credit facilities, can be an effective funding source when integrated into a comprehensive asset-liability management program. While borrowing sources have helped banks successfully manage growth, examiners have observed that institutions with asset quality or capital problems may encounter issues with borrowings when collateral requirements or reduced borrowing capacity affects liquidity. Generally, borrowings are not a substitute for core deposits; instead, they are a complementary funding resource.

# Community Bank Liquidity Risk

continued from pg. 11

**Chart 6: Reliance on Borrowings has Reversed from Post-Crisis Lows**




Source: Call Report Data, Banks with less than $10 billion in total assets

During the post-crisis period, many banks have increased reliance on borrowings to address earnings objectives, loan demand, and a moderation in deposit growth. Chart 6 illustrates how borrowings increased in the years following the financial crisis, as institutions have grown balance sheets with non-deposit funding sources.

In a favorable economic environment, profitable, well-capitalized banks generally have a wide capacity to borrow as they can secure wholesale credit with a pledge of loans or securities. This ample borrowing capacity enables growth and allows management to pursue specific investment strategies. In some cases, banks provide a blanket lien on their mortgage loans and other assets to secure credit. When asset quality and on-balance sheet liquidity are strong, use of secured wholesale credit can be reliable and cost-effective.

However, examiners have observed unexpected, significant liquidity strains when asset quality, capital, and earnings deficiencies limit an institution's capacity to borrow and pledge collateral. In certain cases, even moderate levels of borrowings have adversely affected banks' flexibility as additional collateral is requested, and the terms and availability of funding are tightened.

Further, institutions that have pledged a blanket lien on the loan portfolio have encountered administrative and other challenges in seeking the release of collateral for sale or pledging to other counterparties. For example, key lenders, such as the FHLBs and the Federal Reserve Discount Window, have unique collateral acceptance requirements. Some creditors may only accept original inked-signature mortgage documents rather than electronic or facsimile signatures. Accordingly, it is important to understand the terms, structure, and collateral requirements of borrowings in relation to a bank's overall asset-liability management strategy and potential stress needs.

Overall, management can balance the use of non-core and wholesale funding with prudent capital, earnings, and liquidity considerations through the prism of the institution's approved risk tolerance. For banks relying heavily on brokered and other potentially volatile funding, it is important that risk tolerances and recovery strategies are sufficiently reflected in the asset-liability management program and CFP. Next, the article will address observations regarding CFPs, emphasizing the findings regarding recent examinations of institutions with heavy reliance on potentially non-stable funding sources and weak liquidity risk management.

## *The Contingency Funding Plan – Strategies for Unexpected Circumstances*

A CFP is a tactical strategy to address unexpected liquidity shortfalls caused by internal or external circumstances. Liquidity strains are often linked to financial weaknesses on multiple fronts (credit quality, capital adequacy, funding), and a comprehensive and up-to-to date CFP helps bank management navigate funding and liquidity stress at a time when their resources and attention are dedicated to addressing a number of issues. Examiners have recently identified CFP weaknesses at several institutions that are relying on less stable funding sources to pursue outsized growth. To address the CFP deficiencies, the supervisory responses at these institutions include recommendations such as enhancing scenario testing, including consideration of deposit restrictions that apply to banks that are not well capitalized for PCA purposes, understanding asset encumbrance and back-up line availability, and aligning the CFP with the risk profile and activities of the institution.

It is important for CFPs to describe the institution's strategy for addressing a potential deteriorating liquidity position or cash shortfall. The *2010 Interagency Policy Statement on Funding and Liquidity Risk Management*[9] (Interagency Policy Statement) and the *FDIC Risk Management Supervision Manual of Examination Policies*[10] suggest that a well-developed CFP can outline policies and risk mitigation actions to navigate a range of stress scenarios by establishing clear lines of responsibility and articulating implementation, escalation, and communication procedures. A comprehensive CFP addresses triggering mechanisms and early warning indicators as well as remediation steps explaining how contingent funding sources would be used. The CFP is an evolving process that is updated as conditions or the bank's activities change.

In addition, banks typically establish secondary and, in certain instances, tertiary funding resources in the event liquidity reserves become exhausted or unavailable. The Interagency Policy Statement suggests that institutions identify alternative sources of liquidity and ensure ready access to contingent funding as liquidity pressures may spread from one source to another during a significant stress event. Generally, secondary or back-up funds providers include FHLBs, correspondent institutions, and other counterparties that facilitate repurchase agreements or other money market transactions. The Federal Reserve's Discount Window is also a contingent source of funding. Institutions considering the Discount Window for CFP purposes may want to be aware of the differences between "Primary" and "Secondary" credit, as eligibility and term restrictions may be influenced by a bank's financial condition and regulatory ratings.[11]

[9] 75 *Federal Register* 13656 (Mar. 22, 2010).

[10] *FDIC Manual of Examination Policies*, Section 6.1, Liquidity and Funds Management, available at: https://www.fdic.gov/regulations/safety/manual/section6-1.pdf.

[11] Hendry, Pam, "The Federal Reserve's Discount Window: What It Is and How It Works," *Community Banking Connection*s, Federal Reserve System, Second Issue, 2016. https://www.communitybankingconnections.org/articles/2016/i2/federal-reserve-discount-window.

# Community Bank Liquidity Risk

continued from pg. 13

Community bank CFPs are customized to the institution's business lines, potential funding vulnerabilities, and the strength of its liquid asset buffer. There is no single method for designing a CFP, and examiners will not criticize a bank's plan based solely on its brevity. Banks with more complex activities, products and funding structures generally have detailed CFPs, with cash flow forecasting and scenarios that reflect the complexity. For instance, an institution relying on a rate-sensitive funding source can consider how it would manage rate restrictions in a scenario in which the PCA category falls below well capitalized.

**Intraday Liquidity for Derivative Exposures**

While this article has primarily focused on liquidity for the day-to-day functioning of banks' depository and credit services, intraday liquidity monitoring is an important and often overlooked component of the risk-management process. It is important to effectively manage and understand the requirements associated with derivative-related intraday liquidity to meet payment and settlement obligations in a timely manner. This is particularly important for institutions engaged in payment and settlement activities that involve derivative products. While most community banks do not have large derivatives positions and settlement risk, some use derivatives to hedge interest rate risk exposure. These types of transactions and the potential liquidity implications for margin and settlement obligations are likely appropriate for CFP consideration.

As an example, as part of a derivative transaction, an institution may be required to submit margin or settlement associated with the contract on a given business day by a specific time. Even though the institution may be "in the money" (have a net positive exposure to the dealer counterparty) and expecting a net liquidity inflow, the derivative contract could require a short-term or intraday cash payment. The institution's payment may occur before the counterparty remits its payment, creating a timing difference and potential short-term or intraday liquidity need.

## Determining the Size of the Liquidity Buffer

A number of recent examinations have noted declines in liquid asset buffers, and overall trends show that community banks' liquid assets are declining. The size of the liquid asset buffer is an institution-specific determination that reflects the risk profile and scope of activities of the bank. It is important to consider the bank's minimum operating liquidity level and potential sources of stress given its operations and business plans.

Banks with elevated balance sheet risk and more complex activities tend to experience amplified liquidity stress when they hold minimal liquid assets. Some institutions, including those with more complex funding structures, may struggle to determine the size of the liquid asset cushion.

Certain cash outflows may be very familiar to the bank, such as expected deposit runoff or maturities, borrowings scheduled for refinancing, or large credit commitments, which require funding. However, unanticipated events or stresses can lead to severe liquidity shortfalls. Such strain may be caused by rising credit defaults, operational losses or reputation issues, a disruption in deposit gathering, interest rate or brokered deposit restrictions imposed by statute, or reluctance of counterparties to roll over debt. And of course, time could be needed to sell assets, establish repurchase arrangements or otherwise replace funding sources.

Assessing the peak historical cash flow needs during normal business conditions is a good starting point for a risk manager trying to "size" the liquidity buffer. From there, the cushion could be specified by projecting expected or unexpected needs as measured by liquidity cash-flow forecasts. The liquid asset buffer can provide liquidity (within policy limits and free of encumbrance) during a time of stress, complemented by secondary and tertiary funding sources. The following section offers sample cash flow projection templates, which can help a bank develop templates to maintain an appropriate liquid asset cushion.

## Liquidity Cash Flow Forecasting

Safety-and-soundness principles for pro forma cash flow analyses are outlined in the Interagency Policy Statement and are a valuable risk-management process, especially for institutions that rely heavily on non-core funding sources or other market-sensitive sources, such as securitization. The sophistication of "what-if" scenarios should correspond to the bank's risk profile and activities. Bank management teams who prioritize measuring the adequacy of the liquidity position and evaluating plausible stress scenarios on an ongoing basis can help ensure that the liquid asset cushion and alternative funding sources prudently sustain the institution's operation.

Community bank managers often devise liquidity cash flow forecasts to estimate expected inflows and outflows under a base-case scenario as well as a stressed environment. Examiners have noted some institutions that employ more complex funding structures or concentrated sources are missing important scenario assumptions and potential stresses in their analyses. The following example of cash flow forecasting is presented to illustrate how an institution could employ cash flow forecasting to reflect stress scenarios, build out the contingency

continued from pg. 15

funding plan, and help determine the size of the liquid asset cushion.

An example of pro forma cash flow analysis for a hypothetical $200 million institution is presented in Table 1 and Table 2 with a base-case forecast and a stress scenario, respectively. The example bank is traditional in nature, focusing on local lending funded by core deposits and several non-core sources, including brokered deposits and borrowings. The examples shown are not a supervisory standard or expectation for such analyses, but illustrate how management might approach this exercise from a high level. Institutions can tailor such analyses based on their complexity.

The sample pro forma cash flow is presented across a 12-month time frame with a 30-day short-term liquidity calculation, and cumulative "surplus/deficit" forecasts in the intermediate 90-day and 180-day periods. The rationale for these time horizons is that liquidity crises can be rapid, short-term shocks, or intermediate-term gradual tightening of conditions and funding. For banks with limited liquidity, shorter time frames may be warranted. The pro forma presents expected cash flows at a high level from loan, investment, and funding inflows balanced against outflows from investments and loan renewals as well as deposit withdrawals and repayment of borrowings. On-balance sheet sources of liquidity (unencumbered liquid assets) are included to illustrate the first line of liquidity support. Committed funding lines are not included in the surplus/deficit measure, but are presented as secondary and tertiary sources when needed to address unanticipated growth, deposit runoff, or other stress.

Liquidity policy limits are presented to measure compliance with the board's risk tolerance and as benchmarks for cash flow sufficiency. Limits in the accompanying tables are hypothetical examples only, and are not regulatory standards. If breached, CFP intervention would be triggered, requiring a managerial response with appropriate action steps and board involvement. In addition, internal limits on brokered and listing service deposits are presented to gauge the availability of these potentially volatile and restricted funding sources within board risk tolerances. If management determined that additional brokered or listing service deposits should be used to fund growth or replenish run-off, a limit exception and its justification would be presented to and ratified by the board of directors with subsequent analytical follow-up as appropriate

In the base case, the institution has a reasonable liquidity surplus position that is above its internal policy limit. This is a business-as-usual position with regular cash inflows to support obligations and profitability objectives. The balance sheet is projected to provide a sufficient liquidity cushion above the limit. Still, the table illustrates the availability of alternative funding strategies, if necessary, within limitations imposed by collateral requirements and internal policy.

The bank's asset-liability committee (ALCO) and board would review the base-case, pro forma cash-flow analysis periodically to be adequately informed of the projected near- and intermediate-term liquidity position. The magnitude and frequency of cash-flow analysis are often matched to the complexity of the financial institution and the level of its risk exposures.

**Table 1**

**Bank of Anytown**
**Pro Forma Cash Flow - Base Case**
($000)

| | *0-30 days* | *31-90 days* | *91-180 days* | *181-360 days* | *Current Balance* |
|---|---|---|---|---|---|
| *Expected Cash Outflows:* | | | | | Assets = 200,000 |
| New Loans/Drawdowns | (3,000) | (6,000) | (9,000) | (18,000) | 130,000 |
| New Investment Securities | (3,000) | (1,000) | (1,000) | (1,000) | 45,000 |
| Deposit Withdrawals and Maturities | (1,400) | (2,800) | (4,200) | (8,400) | 140,000 |
| Maturing FHLB Advances | (5,000) | - | (3,000) | - | 40,000 |
| ***Total Periodic Outflows:*** | (12,400) | (9,800) | (17,200) | (27,400) | |
| *Expected Cash Inflows:* | | | | | |
| Fed Funds Sold/Other Overnight | 5,000 | - | - | - | 5,000 |
| New Deposit Growth | 2,800 | 5,600 | 8,400 | 16,800 | |
| Asset Maturities/Payments/ Prepayments | 4,500 | 5,250 | 7,500 | 14,250 | |
| ***Total Periodic Inflows:*** | 12,300 | 10,850 | 15,900 | 31,050 | |
| *Periodic Net Cash Inflow/(Outflow):* | (100) | 1,050 | (1,300) | 3,650 | |
| *Cumulative Net Cash Inflow/(Outflow):* | (100) | 950 | (350) | 3,300 | |
| *Available Liquidity Sources:* | | | | | |
| FRB Reserve Deposit (Excess Reserves) | 10,000 | - | - | - | 10,000 |
| Unpledged Liquid Securities | 30,000 | - | - | - | 30,000 |
| ***Liquid Asset Surplus/(Deficit)*** | 39,900 | 40,950 | 39,650 | 43,300 | |
| *Internal Limit > 18% of Assets* | 20.0% | 20.5% | 19.8% | 21.7% | |
| ***Borrowings/Funding Actions Taken*** | - | - | - | - | |
| ***Total Surplus/(Deficit)*** | 39,900 | 40,950 | 39,650 | 43,300 | |
| Internal Limit > 18% of Assets | 20.0% | 20.5% | 19.8% | 21.7% | |
| **Available Funding Strategies** | | | | | *Current Availability* |
| FHLB Availablity (Secured) | 55,000 | 55,000 | 58,000 | 58,000 | 50,000 |
| Back-up Lines (Unsecured) | 5,000 | 5,000 | 5,000 | 5,000 | 5,000 |
| Brokered Deposit Internal Limit < 10% of Assets | 20,000 | 20,000 | 20,000 | 20,000 | 20,000 |
| Listing Service Internal Limit < 10% of Assets | 20,000 | 20,000 | 20,000 | 20,000 | 20,000 |
| FRB Discount Window Availability (Secured) | 5,000 | 5,000 | 5,000 | 5,000 | 5,000 |
| ***Remaining Borrowings/Funding Availability*** | 105,000 | 105,000 | 108,000 | 108,000 | 100,000 |

**Base-Case Scenario**

**Current balance of various assets/ liabilities**

**Deposit growth/ replacement exceeds outflow**

**Liquid asset balances exceed 18% limit in all time horizons**

**No management action needed in base-case if limit is not breached**

**Maturing FHLB borrowings added back to availability**

continued from pg. 17

As an accompaniment to the base-case cash-flow analysis, a pro forma stressed forecast can be developed to simulate an unexpected, harsh operating condition. To determine the most likely stress scenarios that the institution could face, management can use its unique insight to envision adverse circumstances based on the nature of the institution's business, funding structure, and market considerations. Multiple scenarios can be developed, and changes to these analyses over time may be appropriate as conditions and sources of stress evolve. Ideally, the CFP will identify and quantify these events and explain why they are relevant.

The pro forma stress cash-flow analysis presented in Table 2 depicts a more challenging liquidity situation for the example institution. As background, the stress scenario assumed an unexpected increase in delinquent loans, while market interest rates increased at the same time. Loan repayment problems were exacerbated by the higher payments due from variable-rate borrowers, while cash flows from prepayments on fixed rate loans slowed. These issues adversely affected liquidity, as overall asset cash flows declined by 10 percent. Furthermore, higher interest rates caused a migration of non-maturity deposits to higher-rate certificates of deposit, and some depositors withdrew their funds to seek higher yields offered by competitors. Deposit outflows increased significantly from the base-case to the stress scenario.

As a result of several quarterly operating losses and a declining leverage ratio, the institution was re-categorized as less than well capitalized for PCA purposes. Accordingly, secured creditors demanded additional collateral margins, and unsecured back-up credit lines were terminated. In addition, access to brokered and high-rate deposits was limited.

The stress scenario shown in Table 2 illustrates the impact of the stress factors and management's mitigating actions (in shaded cells). The Liquid Asset Surplus/(Deficit) ratio fell below management's target limit (18 percent of total assets) beginning in the first 30 days. It is assumed that management recognizes a liquidity strain is occurring and, after the loan pipeline completes funding, no new loans are originated or investments purchased after 90 days. Even with this management action, the limit continues to be breached during the entire forecast horizon. Additional management action is shown in the row titled "Borrowings/Funding Actions Taken." This row shows the amount of additional funding needed during each time period which management used to return the institution to compliance with its 18 percent limit. At the end of the forecast period, the bank is left with $3.95 million in borrowing capacity.

Based on the results of their own base-case and stress cash flow forecasts, management teams can reflect on the efficacy of their liquidity governance and limit framework, unencumbered liquid asset position, reliance on non-core funding, and preparedness to take action in a stress event. Some post-analysis questions for management's consideration might be:

- Are cash flow surplus limits consistent with the board's risk tolerance relative to other risks facing the institution?
- Do the pro forma cash-flow analyses illustrate mitigating actions management can take to bring liquidity back in line with limits during stress scenarios?

**Table 2**

| Bank of Anytown<br>Pro Forma Cash Flow - Stress<br>($000) | | | | | | |
|---|---|---|---|---|---|---|
| | *0-30 days* | *31-90 days* | *91-180 days* | *181-360 days* | *Stress* | *Current Balance* |
| *Expected Cash Outflows:* | | | | | | Assets = 200,000 |
| New Loans/Drawdowns | (3,000) | (6,000) | (1,000) | (2,000) | Draws only | 130,000 |
| New Investment Securities | (3,000) | (1,000) | - | - | None after 90 days | 45,000 |
| Deposit Withdrawals and Maturities | (4,200) | (8,400) | (12,600) | (25,200) | +$2,800/mo | 140,000 |
| Maturing FHLB Advances | (5,000) | - | (3,000) | - | | 40,000 |
| ***Total Periodic Outflows:*** | (15,200) | (15,400) | (16,600) | (27,200) | | |
| *Expected Cash Inflows:* | | | | | | |
| Fed Funds Sold/Other Overnight | 5,000 | - | - | - | | 5,000 |
| New Deposit Growth | - | - | - | - | None | |
| Asset Maturities/Payments/ Prepayments | 4,050 | 4,725 | 6,750 | 12,825 | 10% less | |
| ***Total Periodic Inflows:*** | 9,050 | 4,725 | 6,750 | 12,825 | | |
| Periodic Net Cash Inflow/(Outflow): | (6,150) | (10,675) | (9,850) | (14,375) | | |
| Cumulative Net Cash Inflow/(Outflow): | (6,150) | (16,825) | (26,675) | (41,050) | | |
| *Available Liquidity Sources:* | | | | | | |
| FRB Reserve Deposit (Excess Reserves) | 10,000 | - | - | - | | 10,000 |
| Unpledged Securities | 30,000 | - | - | - | | 30,000 |
| Liquid Asset Surplus/(Deficit) | 33,850 | 23,175 | 13,325 | (1,050) | | |
| Internal Limit > 18% of Assets | 16.9% | 11.6% | 6.7% | -0.5% | Limit Breached | |
| ***Borrowings/Funding Actions Taken*** | 2,150 | 10,675 | 9,850 | 14,375 | Borrowings | |
| Cumulative Total Surplus/(Deficit) | 36,000 | 36,000 | 36,000 | 36,000 | | |
| Internal Limit > 18% of Assets | 18.0% | 18.0% | 18.0% | 18.0% | | |
| **Available Funding Strategies** | | | | | | Current Availability |
| FHLB Availablity (Secured) | 32,850 | 22,175 | 15,325 | 950 | 20,000 less | 30,000 |
| Back-up Lines (Unsecured) | - | - | - | - | No Access | - |
| Brokered Deposit Internal Limit < 10% | - | - | - | - | No Access | - |
| Listing Service Internal Limit < 10% | - | - | - | - | No Access | - |
| FRB Discount Window Availability (Secured) | 3,000 | 3,000 | 3,000 | 3,000 | 2,000 less | 3,000 |
| ***Remaining Borrowings/Funding Availability*** | 35,850 | 25,175 | 18,325 | 3,950 | | 33,000 |

Shaded cell indicates management action

**Stress Scenario**

**Deposit outflow increases**

**Limit breached without further corrective action**

**FHLB borrowings utilized to comply with limit**

**Management reduces lending and investment activity after recognition of liquidity stress**

**No deposit inflow and reduced loan cash flows**

**Larger collateral haircuts reduce available borrowings**

**Eliminated access to unsecured borrowings, brokered deposits, and listing services**

continued from pg. 19

- Can capital levels absorb losses from the forced liquidation of assets at a discount from current values?
- Are non-core funding limits appropriate given base-case and stress cash-flow projections? Is a PCA category downgrade appropriately incorporated into the stress scenario regarding brokered and high-rate deposit restrictions?
- Are off-balance sheet exposures incorporated into the analysis, and do they have a liquidity impact?
- Are back-up borrowing lines sufficient relative to potential cash flow needs during a significant adverse event?
- Is the volume of encumbered assets consistent with management's goals regarding a balance between reliance on liquid assets and contingent funding availability?
- How liquid are the various securities in the investment portfolio, and can they be relied upon as a primary source of funding during significant cash outflows?
- How reliable are rate-sensitive liabilities and committed contingency funding lines in stress?

## Conclusion

Maintaining a healthy liquidity position in good times and bad promotes resilience and strengthens a community bank's ability to provide critical financial services. Many community bank management teams have worked diligently to strengthen their liquidity risk-management processes since the financial crisis, and these steps can help mitigate the effects of an unexpected stress event or cash shortfall. FDIC examiners have observed balance sheet trends and risk-management practices that raise concerns about rising liquidity risk exposure in a subset of community banks. These institutions have grown their assets using higher levels of potentially non-stable funding sources, which could cause prospective financial strain or liquidity stress.

It is important for management teams that pursue more complex funding and aggressive growth strategies to ensure strong liquidity monitoring and governance efforts, coupled with an appropriate liquid asset cushion and contingency planning. These building blocks are necessary to facilitate safe-and-sound operations in a range of normal and unanticipated business conditions. Additionally, the observations and examples in this article may also help raise awareness about certain limitations and operational considerations that could influence the execution of CFPs in a time of stress.

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# The Bank Secrecy Act: A Supervisory Update

## Introduction

Financial institutions play a crucial role in our nation's efforts to combat financial fraud, money laundering, and the financing of terrorism through their compliance with the *Bank Secrecy Act* (BSA). These crimes pose a critical challenge to the integrity and security of, as well as public confidence in, our financial system and can impact our national security. The FDIC and other financial regulatory agencies conduct BSA examinations to assess whether depository institutions have established and maintained BSA compliance programs commensurate with their money laundering and terrorist financing risk. Although deficiencies may be identified during examinations, the vast majority of FDIC-supervised institutions are able to address any BSA compliance deficiencies identified through the supervisory process in the normal course, without the need for a formal enforcement action. However, there are limited instances where such deficiencies constitute a BSA compliance program problem that necessitates formal remediation.

This article describes the BSA, provides a short BSA history, conveys how BSA compliance is examined by the FDIC, and contains examples of the limited instances where a BSA-related formal enforcement action was necessary.

## What is the Bank Secrecy Act and Why is it Important?

The BSA is the common name for a series of laws and regulations that have been enacted in the United States to combat money laundering and the financing of terrorism. The BSA provides a foundation to promote financial transparency and deter and detect those who seek to misuse the U.S. financial system to launder criminal proceeds, finance terrorist acts, or move funds for other illicit purposes.

Under the law, financial institutions have a responsibility to monitor for suspicious activities and to identify and report those suspicious activities to law enforcement. Identifying and reporting suspicious financial transactions are critical to law enforcement's ability to combat drug trafficking, organized criminal activity, and terrorism. Financial institution reporting has been instrumental in the successful investigations of fraud schemes, drug trafficking, money laundering, foreign terrorist fighters, and the proliferation of weapons of mass destruction.[1]

## BSA History

The BSA has evolved from currency transaction reporting requirements to include required BSA compliance programs, suspicious activity monitoring, and other reporting requirements aiming to better identify money laundering, terrorist financing, and other illicit financial activities. To understand the regulatory framework as it exists today, it is important to provide the historical context for certain anti-money laundering (AML) and combating the financing of terrorism (CFT) laws.

When Congress enacted the BSA in 1970, its primary intent was to require institutions to maintain certain records the government could use to support criminal and tax evasion

[1] The Financial Crimes Enforcement Network's Law Enforcement Awards ceremony, May 9, 2017.

continued from pg. 21

investigations. The *Bank Records and Foreign Transaction Act*, or BSA, addressed two issues that were impeding law enforcement agencies' ability to investigate and prosecute criminal activity: the lack of financial recordkeeping by financial institutions and the use of foreign bank accounts located in jurisdictions with strict secrecy laws. Although the initial enactment of the BSA sought to support criminal investigations related to the illegal movement of funds by requiring currency and foreign bank account reporting requirements, the act of money laundering itself was not considered illegal in the U.S. until sixteen years later.

Along with criminalizing money laundering and prohibiting the act of structuring transactions to evade reporting requirements, the *Money Laundering Control Act of 1986* addressed the federal financial regulatory agencies' (Agencies)[2] supervision and enforcement authorities. The act added requirements that are prominent in today's administration of the BSA. Namely, it required the Agencies to examine for BSA compliance during each examination cycle, issue regulations requiring depository institutions to establish and maintain BSA compliance procedures, and issue cease and desist orders to address a depository institution's failure to establish and maintain BSA compliance procedures or failure to correct a previously identified problem with its BSA compliance procedures.

Subsequent to the enactment of the *Money Laundering Control Act,* the Agencies issued regulations requiring depository institutions to establish and maintain BSA compliance programs. This requirement provided an early framework for supervision and enforcement of compliance with the BSA.

In 1992, Congress enacted the *Annunzio-Wylie Anti-Money Laundering Act*, which established suspicious activity reporting and funds transfer recordkeeping requirements. It also included a provision giving certain Agencies the authority to revoke banking charters or to terminate deposit insurance for institutions convicted of a money laundering offense after one of the "earliest glaring examples of financial crime perpetrated by and through an international banking institution"[3] was brought to light.

> *The Bank of Credit and Commerce International (BCCI) was operating in 78 countries and held assets of more than $20 billion when regulatory and law enforcement authorities in a number of jurisdictions discovered that the institution was a massive conduit for money laundering and other financial crimes, and had illegally acquired a controlling interest in a U.S. institution. Before it was closed in 1991, BCCI had provided banking services to a number of senior foreign political figures, often referred to as "politically exposed persons," such as Saddam Hussein, Manuel Noriega, and Abu Nidal, as well as to the Medellin Cartel.*

By the end of the century, several legislative initiatives addressed the movement of illicit funds through an

[2] For purposes of this article, the federal financial regulatory agencies are the Federal Deposit Insurance Corporation, Board of Governors of the Federal Reserve System, Office of the Comptroller of the Currency, and National Credit Union Administration.

[3] Gruenberg, Martin J. "Fostering Financial Integrity – The Role of Regulators, Industry, and Educators, Remarks" at Case Western University School of Law Financial Integrity Institute, March 23, 2017.

increasingly global financial system; however, forthcoming events would emphasize the urgency to enact preventative measures under the BSA. The attacks of September 11, 2001, underscored the relationship between financial crime and terrorist financing in that terrorist groups use methods similar to those of money launderers and criminal organizations to avoid detection. The need to identify and report suspicious financial transactions that may be supporting terrorism was recognized as a necessary element in the fight against terrorism. Shortly thereafter, Congress passed the *Uniting and Strengthening America by Providing Appropriate Tools Required to Intercept and Obstruct Terrorism* (USA PATRIOT) Act in October of 2001.

The USA PATRIOT Act is one of the most significant AML/CFT laws that Congress has enacted since the BSA itself. Among other things, the law criminalized the financing of terrorism, authorized the Agencies to impose customer identification requirements on financial institutions, established information sharing provisions, and required enhanced due diligence by financial institutions for certain foreign correspondent and private banking accounts.

Another notable change implemented by the USA PATRIOT Act was to elevate the Financial Crimes Enforcement Network[4] (FinCEN) from an office to a bureau of the U.S. Department of the Treasury. FinCEN is the designated administrator of the BSA and serves as the financial intelligence unit of the United States. In its capacity as administrator, FinCEN issues regulations and interpretive guidance, provides outreach to regulated industries, supports the examination functions performed by federal and state agencies, and pursues civil enforcement actions when warranted. FinCEN's other responsibilities include collecting, analyzing, and disseminating information received from institutions subject to the BSA, and identifying and communicating financial crime trends and patterns. Importantly, FinCEN has delegated much of its examination authority to regulatory agencies, including the FDIC.

## How is BSA Compliance Examined?

The evolution of the BSA lays the foundation for the current AML/CFT framework. Law enforcement and regulatory agencies play a role related to BSA/AML compliance. The FDIC and state bank regulatory agencies[5] conduct BSA/AML examinations for insured state nonmember institutions.[6]

[4] FinCEN was established in 1990 as an office within the Treasury Department to support law enforcement efforts and foster interagency and global cooperation against domestic and international financial crimes. In 1994, its mission was broadened to include regulatory responsibilities, and the Treasury Department's precursor of FinCEN, the Office of Financial Enforcement was merged with FinCEN. On September 26, 2002, Title III of the USA PATRIOT Act was passed and included a provision to elevate FinCEN as an official bureau in the Department of the Treasury.

[5] The majority of state bank regulatory agencies examine for BSA/AML compliance. The FDIC conducts BSA/AML examinations for those states that do not conduct BSA/AML examinations; which averages less than 20 BSA/AML examinations annually on behalf of state counterparts.

[6] Insured state nonmember institutions are state-chartered institutions that are not members of the Federal Reserve System. The Office of the Comptroller of the Currency examines national banks for BSA/AML compliance, and the Federal Reserve conducts BSA/AML examinations for state-chartered banks that are members of the Federal Reserve System. Federally insured credit unions are examined for BSA/AML compliance by the National Credit Union Administration.

continued from pg. 23

During each safety-and-soundness examination, the FDIC evaluates the institution's compliance with the BSA and its implementing regulations[7] as well the FDIC's own BSA compliance program[8] and suspicious activity reporting[9] requirements. The focus of a BSA/AML examination is to assess whether the institution has established and maintains a BSA compliance program that is commensurate with the institution's money laundering and terrorist financing risks.

Under Section 8(s) of the Federal Deposit Insurance (FDI) Act, the FDIC is directed to prescribe regulations requiring each FDIC-supervised institution to establish and maintain procedures reasonably designed to assure and monitor the institution's compliance with the requirements of the BSA and its implementing regulations.[10] Section 326.8 of the FDIC's Rules and Regulations implements Section 8(s) of the FDI Act and establishes a BSA compliance program requirement. Under Section 326.8, an FDIC-supervised institution's BSA compliance program must contain the following components:

- A system of internal controls to assure ongoing compliance with the BSA;
- Independent testing for BSA compliance;
- A designated individual(s) responsible for coordinating and monitoring BSA compliance; and
- Training for appropriate personnel.

In addition, a BSA compliance program must include a customer identification program (CIP) with risk-based procedures that enable the institution to form a reasonable belief that it knows the true identity of its customers.

Section 8(s) of the FDI Act also provides that the FDIC shall issue a cease and desist order against an FDIC-supervised institution that has failed to establish and maintain a BSA compliance program or has failed to correct any problem with its BSA compliance program that was previously reported to the institution. To be an uncorrected problem with the BSA compliance program that will result in a cease and desist order under Section 8(s), deficiencies in the BSA compliance program must be identified in a report of examination or other written document as requiring communication to an institution's board of directors or senior management for correction.

The FDIC implements a risk-based approach to assess compliance with the BSA and considers an institution's risk profile and potential exposure to money laundering and terrorist financing. When BSA compliance deficiencies are identified, they are communicated to an institution's management through a variety of channels including informal discussions during the examination process, formal discussions following the examination process, findings in reports of examinations, or other formal communications. The particular method of communication used typically depends on the seriousness of the concerns.

In cases in which prompt remedial action is not taken by management, corrective actions are not effectively

[7] 31 CFR Chapter X.

[8] 12 CFR 326.8.

[9] 12 CFR 353.

[10] 12 USC 1818(s).

implemented, or there are serious concerns related to the compliance deficiency, the FDIC will consider a range of corrective options based on the severity of the deficiency, management's willingness and ability to correct the deficiency, and the money laundering and terrorist financing risk posed to the institution. These corrective options include informal enforcement actions such as memoranda of understanding and formal enforcement actions such as cease and desist or consent orders.

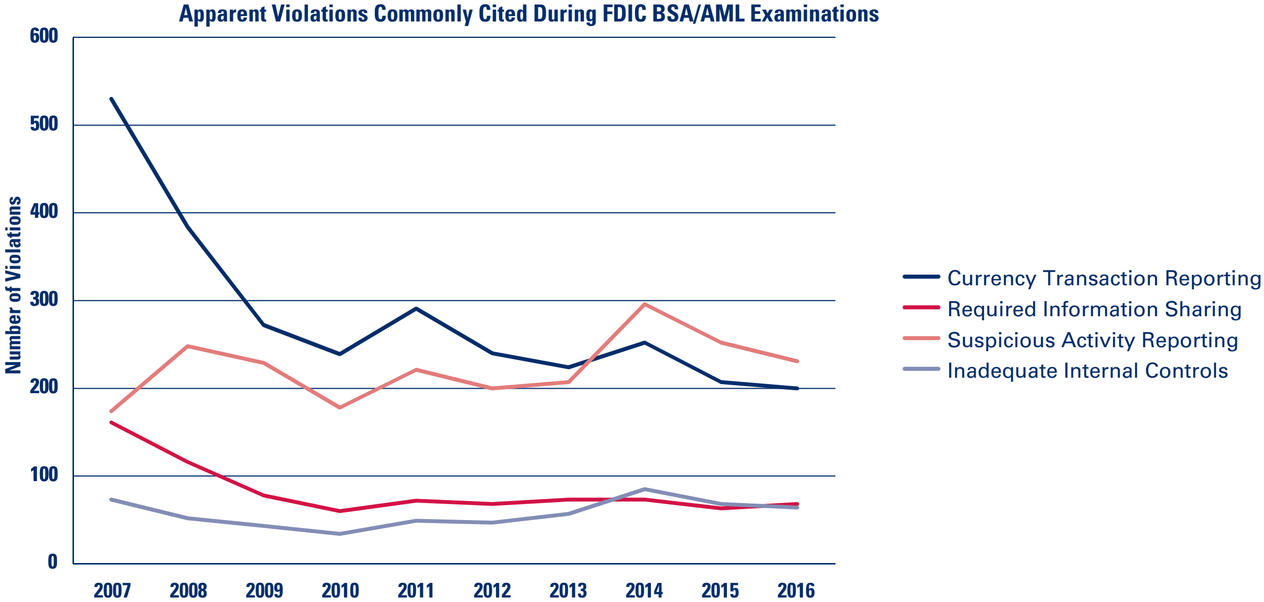
The *Interagency Statement on Enforcement of Bank Secrecy Act/Anti-Money Laundering Requirements*[11] details circumstances in which the FDIC will issue a cease and desist order to address noncompliance with BSA/AML requirements. The guidance discusses instances in which formal enforcement actions will be issued for BSA compliance program problems and failures under Section 8(s) of the FDI Act.

## What Does the FDIC Find in its BSA Examinations?

In the vast majority of examinations, the FDIC finds that institutions generally comply with the BSA. When examiners find BSA compliance deficiencies, they are often technical recordkeeping or reporting matters that can be addressed in the normal course of business.

The most common apparent violations of BSA regulations that are cited during the FDIC's BSA/AML examinations are related to currency transaction report filings and information sharing requirements. Common violations under the FDIC's BSA compliance program and suspicious activity reporting requirements relate to suspicious activity report filing deficiencies and inadequate systems of internal controls. The table below illustrates the number of aforementioned apparent violations that were cited over the previous 10 years.

**Apparent Violations Commonly Cited During FDIC BSA/AML Examinations**




Source: FDIC BSA/AML Examinations 2007-2016

[11] Financial Institution Letter FIL 71-2007 and the *Federal Financial Institutions Examination Council BSA/AML Examination Manual*, Appendix R.

# Bank Secrecy Act

continued from pg. 25

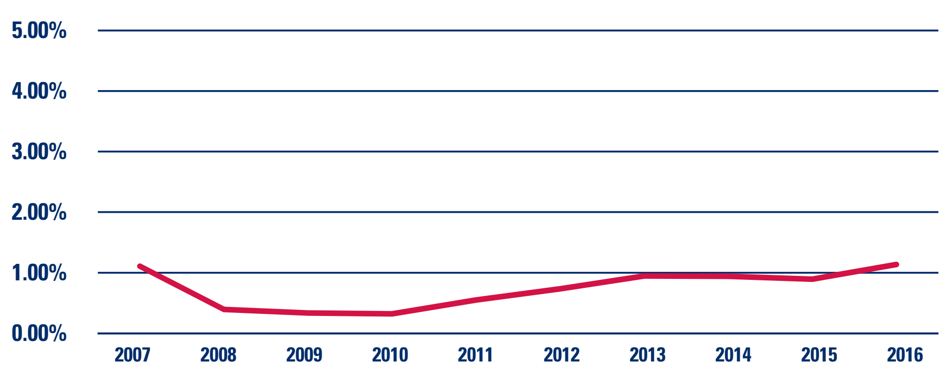
Institutions can prevent compliance deficiencies related to these commonly cited violations by maintaining effective BSA/AML internal control structures. For example, information sharing compliance deficiencies may be corrected by designating persons responsible for conducting searches, keeping contact information up to date with FinCEN, and establishing policies, procedures and processes that clearly outline methods for conducting and documenting information sharing request searches, as well as reporting the results of those searches, as necessary.

Compliance deficiencies related to suspicious activity reporting can be prevented with trained staff and the implementation of systems to identify, research, and report unusual activity. Training and systems should be commensurate with an institution's overall risk profile and include effective decision-making processes. Effective decision-making processes should be supported by adequate documentation regarding decisions to file or not to file a suspicious activity report (SAR). Because SAR decision making requires review, analysis, and judgment of transactions, institutions should maintain effective internal control systems that establish appropriate policies, procedures, and processes for suspicious activity monitoring and reporting.

BSA compliance deficiencies range from technical violations of BSA regulations, such as a failure to file a timely currency transaction report (CTR) to more severe BSA compliance program failures. Technical violations alone do not warrant criticism of an institution's BSA compliance program, but may be indicators of more significant deficiencies with BSA compliance program components. For instance, multiple apparent violations for failure to file CTRs may be the result of deficiencies in the institution's monitoring process and could be indicative of a problem with one or more BSA compliance program components, such as the internal controls and training components.

Compliance deficiencies often result in citations of apparent violations, but citations of violations do not necessarily result in the issuance of enforcement actions. During the past ten years, approximately one percent of examinations resulted in BSA/AML formal enforcement actions.

**FDIC BSA/AML Basis Consent Orders as a % of FDIC BSA/AML Examinations**




Source: FDIC Annual Reports 2007-2016

## When Does the FDIC Use a Formal Enforcement Action to Address BSA Problems?

Pursuant to the Interagency Enforcement Guidance previously mentioned, the FDIC will issue a cease and desist order based on a violation of the requirement in Section 8(s) to establish and maintain a reasonably designed BSA compliance program where the institution:

- Fails to have a written BSA compliance program, including a CIP that adequately covers the required program components (i.e., internal controls, independent testing, designated compliance personnel, and training); or
- Fails to implement a BSA compliance program that adequately covers the required program components.

The FDIC will also issue a cease and desist order under Section 8(s) where the institution:

- Has defects in its BSA compliance program in one or more program components that indicate that either the written program or its implementation is not effective.

The following provides an example of where BSA compliance program defects, coupled with other aggregating factors, such as the potential for unreported money laundering activities, rendered the program ineffective thereby requiring a cease and desist order under Section 8(s).

**Institution A**

The institution rapidly expanded its international business relationships through its foreign affiliates and businesses without identifying its BSA/AML risk or adjusting its BSA compliance program. The majority of the institution's customers were residents of foreign countries, with approximately 20 percent of the customer base consisting of politically exposed persons. The institution offered a variety of products and services, which included U.S. dollar-denominated credit cards, settlement accounts for money services businesses, currency exchange, cross-border remittances, and currency transfers between foreign affiliates and the institution. In addition, the institution conducted domestic and international wire transfers, with the annual international wire transfer activity representing nearly 100 percent of tier 1 capital.

The depository institution did not have procedures in place to verify customers' identities or monitor for suspicious activity related to its products and services. Numerous systemic deficiencies were identified in the institution's BSA/AML policies, procedures, and processes, which included an inadequate BSA/AML risk assessment, weak customer due diligence and enhanced due diligence programs, and significant lapses in monitoring for, and the reporting of, suspicious activities. The BSA department was substantially understaffed, and the designated BSA officer did not have the sufficient authority or resources to properly oversee the institution's BSA compliance program.

The institution's BSA compliance deficiencies stemmed from a failure of internal controls, inadequate BSA/AML staff and resources, ineffective training, and inadequate independent testing for BSA compliance. As a result, the institution's BSA compliance program was considered ineffective. Accordingly, apparent violations related to all BSA compliance program components were cited in the report of examination, as well as an apparent violation for the institution's failure to implement an adequate BSA compliance program.

continued from pg. 27

Based on a review of relevant facts and circumstances, the FDIC also will issue a cease and desist order when an institution fails to correct a previously reported problem with its BSA compliance program. To be considered a problem within the meaning of Section 8(s), a deficiency would generally involve a serious defect in one or more of the required BSA compliance program components, and would have been identified in a report of examination or other written supervisory communication as requiring communication to the institution's board of directors or senior management as a matter that must be corrected.

The FDIC does not ordinarily issue a cease and desist order under Section 8(s) unless the deficiencies identified during a subsequent examination or visitation are substantially the same as those previously reported to the institution. For example:

**Institution B**

During an examination, the institution's system of internal controls was considered inadequate as a result of compliance failures related to customer due diligence and suspicious activity monitoring processes. Specifically, the institution had not developed customer risk profiles to identify, monitor, and report suspicious activities related to the institution's business customers. Additionally, the institution had not implemented an effective system to identify, research, and report suspicious activity. Notably, there was a significant number of suspicious activity monitoring system alerts that had not been properly researched and resolved.

Apparent violations were cited as a result of the institution's inadequate system of internal controls and numerous instances where the institution failed to meet suspicious activity reporting requirements. The report of examination identified a problem with the internal controls component of the institution's BSA compliance program, which required board attention and management's correction. The issue was explained in the report of examination, which was reviewed by the institution's senior management and board of directors. After the examination, an informal enforcement action was issued to address the problem.

Subsequent examination findings determined that management had not satisfactorily addressed the previously reported problem with its BSA compliance program. Customer risk profiles remained undeveloped for the institution's business customers and suspicious activity identification, monitoring, and reporting processes remained inadequate. The number of outstanding suspicious activity monitoring system alerts had increased substantially, resulting in additional instances where the institution failed to meet suspicious activity reporting requirements. As a result, a cease and desist order was issued pursuant to Section 8(s) of the FDI Act because of the institution's failure to correct the previously identified problem with its BSA compliance program.

Certain problems with an institution's BSA compliance program may not be fully correctable before the next examination or visit, such as when correction is addressed through implementing a new computer system. In these instances, a cease and desist order would not be issued if the institution had made substantial progress and acted in a timely fashion toward correcting the identified issues, provided the institution had adequate measures to comply with the BSA.

## Conclusion

BSA compliance programs are integral elements in the AML/CFT framework as they aid in the prevention and detection of bad actors seeking to misuse the financial system. Depository institutions are required to establish a BSA compliance program commensurate with the risk profile of the institution. Most BSA compliance program deficiencies are corrected during the normal course of the supervisory process without the need for a formal enforcement action. When BSA compliance program deficiencies become problems, the FDIC provides recommendations to address the contributing factors through a variety of means before considering issuing a formal enforcement action.

The FDIC recognizes the challenges and costs associated with BSA compliance, especially as criminal organizations, terrorist financiers, and other illicit actors use creative and increasingly sophisticated methods to adapt to changes in the financial, technological, and regulatory landscape. The vast majority of FDIC-supervised institutions are successful in complying with the BSA, and play an important role in promoting public confidence and stability in the financial system.

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# Overview of Selected Regulations and Supervisory Guidance

This section provides an overview of recently released regulations and supervisory guidance, arranged in reverse chronological order. Press Release (PR) and Financial Institution Letter (FIL) designations are included so the reader can obtain more information.

| ACRONYMS and DEFINITIONS | |
|---|---|
| CFPB | Consumer Financial Protection Bureau |
| FDIC | Federal Deposit Insurance Corporation |
| FFIEC | Federal Financial Institutions Examination Council |
| FRB | Federal Reserve Board |
| NCUA | National Credit Union Administration |
| OCC | Office of the Comptroller of the Currency |
| Federal bank regulatory agencies | FDIC, FRB, and OCC |
| Federal financial institution regulatory agencies | CFPB, FDIC, FRB, NCUA, and OCC |

| Subject | Summary |
|---|---|
| **Securities and Exchange Commission Rule Amended to Shorten the Securities Transaction Settlement Cycle (FIL-32-2017, July 26, 2017)** | The FDIC is highlighting actions banks should take to prepare for the change in the Securities Exchange Commission's rule governing the securities settlement cycle for securities transactions conducted by most broker-dealers. Effective September 5, 2017, the industry settlement cycle for transactions involving many U.S. securities, including equities, corporate and municipal bonds, and other financial instruments, will be shortened from the third business day after the trade date to the second business day after the trade date.<br>See https://fdic.gov/news/news/financial/2017/fil17032.html. |
| **Update to the Risk Management Manual of Examination Policies (FIL-31-2017, July 26, 2017)** | The FDIC *Risk Management Manual of Examination Policies* has been updated to incorporate guidance from the FDIC Board of Directors to examiners regarding supervisory recommendations, including matters requiring board attention and deviations from underlying policy statements and safety-and-soundness principles. The updated Manual implements the July 29, 2016, FDIC Board of Directors statement on the *Development and Communication of Supervisory Recommendations*, which instructs examiners that supervisory recommendations must be clearly communicated in writing, address meaningful concerns, and discuss corrective actions.<br>See https://fdic.gov/news/news/financial/2017/fil17031.html. |
| **FDIC Updates *Affordable Mortgage Lending Guide* Information on State Housing Finance Agencies (FIL-30-2017, July 26, 2017)** | The FDIC has updated the *Affordable Mortgage Lending Guide, Part II: State Housing Finance Agencies* to reflect the most up-to-date information available about the mortgage programs offered through state housing finance agencies (HFAs). The publication describes state HFA products and programs that provide home purchase support, including down payment closing cost assistance, mortgage tax credit certificates, and homeownership education and counseling.<br>See https://fdic.gov/news/news/financial/2017/fil17030.html. |

| Subject | Summary |
|---|---|
| **Federal Regulatory Agencies Announce Coordination of Reviews for Certain Foreign Funds Under "Volcker Rule" (PR-56-2017, July 21, 2017)** | The federal financial institution regulatory agencies are coordinating respective reviews of the treatment of certain foreign funds under Section 619 of the *Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010* (Dodd-Frank Act). Section 619 generally prohibits insured depository institutions and any affiliates from engaging in proprietary trading and acquiring or retaining ownership interests in a "covered fund" as defined under the agencies' implementing regulations. Although these particular foreign funds are investment funds organized and offered outside the United States that are excluded from the definition of a covered fund (foreign excluded funds), complexities in the statute and implementing regulations may result in certain foreign excluded funds becoming subject to regulation under Section 619 because of government arrangements with or investments by foreign banks.<br>See https://fdic.gov/news/news/press/2017/pr17056.html. |
| **Appraisal Threshold for Commercial Real Estate Transactions (FIL-29-2017/ PR-55-2017, July 19, 2017)** | The federal bank regulatory agencies are issuing a Notice of Proposed Rulemaking titled *Real Estate Appraisals* (Appraisal NPR), which will be published in the *Federal Register* for a 60-day comment period. The Appraisal NPR proposes to increase the current appraisal threshold for commercial real estate transactions from $250,000 to $400,000. The Appraisal NPR can be accessed through the FDIC's website at https://fdic.gov/news/board/2017/2017-07-18-notice-dis-a-fr.pdf.<br>See https://fdic.gov/news/news/financial/2017/fil17029.html. |
| **FDIC Revises Supervisory Appeals Guidelines (PR-54-2017, July 18, 2017)** | The FDIC revised its guidelines for appeals of certain material supervisory determinations (determination) to expand the circumstances under which banks may appeal a determination and enhance consistency with the appeals processes of other federal banking agencies. Determinations that are appealable under the guidelines include examination ratings, determinations relating to the adequacy of provisions for loan and lease losses, and classifications of loans and other assets. The amended guidelines permit the appeal of matters requiring board attention and determinations made regarding an institution's level of compliance with a formal enforcement action.<br>See https://fdic.gov/news/news/press/2017/pr17054.html. |
| **Consolidated Reports of Condition and Income for Second Quarter 2017 (FIL-27-2017, July 12, 2017, and FIL-28-2017, July 13, 2017)** | The Consolidated Reports of Condition and Income (Call Report) for the June 30, 2017 report date must be submitted to the FFIEC's Central Data Repository by July 30, 2017. Although there are no new or revised data items that take effect for June 2017 in the FFIEC 051, FFIEC 041, and FFIEC 031 Call Reports, the FFIEC implemented a new streamlined FFIEC 051 Call Report for eligible small institutions as of the March 31, 2017 report date. Eligible small institutions, generally those with domestic offices only and total assets less than $1 billion, have the option to file either the FFIEC 051 or the FFIEC 041 Call Report. The Call Report forms for June 2017 are available on the FFIEC's website at https://www.ffiec.gov/ffiec_report_forms.htm and the FDIC's website at https://www.fdic.gov/callreports.<br>See https://fdic.gov/news/news/financial/2017/fil17027.html<br>and https://fdic.gov/news/news/financial/2017/fil17028.html. |
| **FDIC Announces Meeting of Advisory Committee on Community Banking (PR-53-2017, July 10, 2017)** | The FDIC will hold a meeting of the Advisory Committee on Community Banking on Wednesday July 12, 2017. Senior staff will discuss and provide updates on supervisory issues such as liquidity risk, *de novo* applications, appraisals, Call Reports, capital, and examination processes. There also will be presentations on the post-crisis performance of community banks and the outlook for community banking. The agenda for the meeting and a link to the webcast are available at FDIC's Advisory Committee on Community Banking website, https://www.fdic.gov/communitybanking.<br>See https://fdic.gov/news/news/press/2017/pr17053.html. |

# Regulatory and Supervisory Roundup

continued from pg. 31

| Subject | Summary |
|---|---|
| **FDIC Seeks Comments on Manual for Processing Deposit Insurance Applications (FIL-26-2017/PR-52-2017, July 10, 2017)** | The FDIC is seeking public comment on a procedures manual developed to assist FDIC staff as they evaluate and process deposit insurance applications. The manual addresses each stage of the insurance application process from pre-filing activities to application acceptance, review, and processing; preopening activities; and post-opening considerations. Comments should be submitted to manualcomments@fdic.gov by September 8, 2017.<br>See https://fdic.gov/news/news/financial/2017/fil17026.html. |
| **Agencies Post Public Sections of Resolution Plans; Announce Deadline Extension for Two Non-Bank Financial Firms (PR-51-2017, July 5, 2017)** | The FRB and the FDIC posted the public portions of annual resolution plans for eight large financial firms. Resolution plans, required by the Dodd-Frank Act and commonly known as living wills, must describe the company's strategy for rapid and orderly resolution under bankruptcy in the event of material financial distress or failure of the company. The public portions of the resolution plans are available on the FDIC (www.fdic.gov/regulations/reform/resplans/index.html) and Board (www.federalreserve.gov/bankinforeg/resolution-plans.htm) websites. The agencies will begin reviewing the confidential and public portions of the resolution plans.<br>See https://fdic.gov/news/news/press/2017/pr17051.html. |
| **Proposed Revisions to the Consolidated Reports of Condition and Income (Call Report) (FIL-24-2017, June 27, 2017, and FIL-25-2017, June 29, 2017)** | The federal bank regulatory agencies are requesting comment on additional revisions and certain other reporting changes to all three versions of the Call Report. The proposal results from ongoing efforts by the FFIEC to ease and reduce reporting requirements. Redlined copies of the FFIEC 051, FFIEC 041, and FFIEC 031 report forms showing the proposed Call Report revisions and lists detailing the data items on each version of the Call Report affected by the proposed changes are available on the FFIEC's website (https://www.ffiec.gov/ffiec_report_forms.htm). These revisions are proposed to take effect March 31, 2018; and institutions are encouraged to comment on the proposal by August 28, 2017.<br>See https://fdic.gov/news/news/financial/2017/fil17024.html<br>and https://fdic.gov/news/news/financial/2017/fil17025.html. |
| **Agencies Release List of Distressed or Underserved Nonmetropolitan Middle-Income Geographies (PR-48-2017, June 21, 2017)** | The federal bank regulatory agencies announced the availability of the 2017 list of distressed or underserved nonmetropolitan middle-income geographies, where revitalization or stabilization activities are eligible to receive Community Reinvestment Act (CRA) consideration under the community development definition. The criteria for designating these areas in accordance with CRA regulations are available on the FFIEC website (http://www.ffiec.gov/cra).<br>See https://fdic.gov/news/news/press/2017/pr17048.html. |
| **Agencies Issue Host State Loan-to-Deposit Ratios (PR-47-2017, June 21, 2017)** | The federal bank regulatory agencies issued the host state loan-to-deposit ratios that will be used for determining compliance with Section 109 of the *Riegle-Neal Interstate Banking and Branching Efficiency Act of 1994*. These ratios replace the prior year's ratios, which were released on June 17, 2016. In general, Section 109 prohibits a bank from establishing or acquiring a branch or branches outside its home state primarily for the purpose of deposit production.<br>See https://fdic.gov/news/news/press/2017/pr17047.html. |

| Subject | Summary |
| --- | --- |
| ***FDIC Consumer News* Issues Warning About 10 Scams Targeting Bank Customers (PR-45-2017, June 12, 2017)** | The Summer 2017 *FDIC Consumer News* alerts the public to common scams and provides basic tips for protecting personal information and money. Topics include an overview of 10 schemes bank customers need to be aware of, including the crime that occurs when thieves pose as government employees claiming to need a payment of some sort or valuable information, such as Social Security or bank account numbers. The Summer 2017 *FDIC Consumer News* is available at www.fdic.gov/consumers/consumer/news/cnsum17.<br>See https://fdic.gov/news/news/press/2017/pr17045.html. |
| **Adoption of Supervisory Guidance on Model Risk Management (FIL-22-2017, June 7, 2017)** | The FDIC is adopting the *Supervisory Guidance on Model Risk Management* previously issued by the OCC and the FRB to facilitate consistent model risk management expectations across the banking agencies and industry. The guidance addresses supervisory expectations for model risk management, including model development, implementation, and use; model validation; and governance, policies, and controls. It is not expected that this guidance will pertain to FDIC-supervised institutions with under $1 billion in total assets unless the institution's model use is significant, complex, or poses elevated risk to the institution.<br>See https://fdic.gov/news/news/financial/2017/fil17022.html. |
| **Summary of Deposits Survey: Filing for June 30, 2017 (FIL-21-2017, June 7, 2017)** | The Summary of Deposits (SOD) is the annual survey of branch office deposits as of June 30 for all FDIC-insured institutions, including insured U.S. branches of foreign banks. Institutions with branch offices are required to submit the survey to the FDIC by July 31, 2017. Comprehensive reporting instructions for the 2017 SOD Survey are available on the FDIC's SOD website at https://fdic.gov/regulations/required.<br>See https://fdic.gov/news/news/financial/2017/fil17021.html. |
| **Advisory on the Availability of Appraisers (FIL-19-2017/ PR-42-2017, May 31, 2017)** | Responding to concerns over the limited availability of state-certified and -licensed appraisers, particularly in rural areas, the federal financial institution regulatory agencies are issuing an advisory that discusses two methods that may address any appraiser shortages: temporary practice permits and temporary waivers. The first option highlighted in the advisory, temporary practice permits, allows appraisers credentialed in one state to provide their services on a temporary basis in another state experiencing a shortage of appraisers, subject to state law. The second option, temporary waivers, may be granted when it is determined there is a scarcity of state-certified or -licensed appraisers leading to significant delays in obtaining an appraisal.<br>See https://fdic.gov/news/news/financial/2017/fil17019.html |
| **Deposit Insurance Coverage Seminars:**<br>**Free Nationwide Seminars for Bank Officers and Employees**<br>**(FIL-18-2017, May 18, 2017)** | The FDIC will conduct four identical live seminars on FDIC deposit insurance coverage for bank employees and bank officers between June 6, 2017, and December 4, 2017, via Cisco WebEx. In addition to the comprehensive overview of FDIC deposit insurance rules, the seminars include deposit insurance coverage information for Prepaid Cards, Health Savings Accounts, 529 plan accounts and 529 Achieving a Better Life Experience plan accounts. Also, the FDIC has developed three separate Deposit Insurance Coverage Seminars for bank officers and employees available on the FDIC's YouTube channel.<br>See https://fdic.gov/news/news/financial/2017/fil17018.html |

# Regulatory and Supervisory Roundup

continued from pg. 33

| Subject | Summary |
|---|---|
| **FDIC Releases Final Handbook for Organizers of *De Novo* Institutions (FIL-17-2017/ PR-35-2017, May 1, 2017)** | *Applying for Deposit Insurance – A Handbook for Organizers of De Novo Institutions* provides an overview of the business considerations and statutory requirements that *de novo* organizers will face as they work to apply for deposit insurance and establish a new depository institution. The handbook provides guidance for navigating the three phases of establishing an insured institution, which are the pre-filing activities, the application process, and pre-opening activities.<br>The handbook is available on the FDIC's website at<br>https://www.fdic.gov/regulations/applications/handbook.pdf.<br>See https://fdic.gov/news/news/financial/2017/fil17017.html |
| **FDIC Advisory Committee on Economic Inclusion to Meet (PR-31-2017, April 24, 2017)** | The FDIC Advisory Committee on Economic Inclusion will meet on April 27, 2017, to discuss measures banks may consider, such as collaborations with community-based organizations and resources for affordable mortgage lending, to reach underserved populations. The meeting agenda and a link to the webcast can be found at https://fdic.gov/about/comein/2017/2017-04-27-agenda.html.<br>See https://fdic.gov/news/news/press/2017/pr17031.html |
| **FDIC to Host Economic Inclusion Summit in Arlington, Virginia (PR-30-2017, April 7, 2017)** | The FDIC will host an Economic Inclusion Summit on April 26, 2017 to discuss "Strategies to Bring Consumers into the Financial Mainstream." The summit will bring together representatives from banks, trade associations, nonprofit organizations, government agencies, and the public. It will explore means for increasing access to the mainstream financial system for underserved consumers including strategies for establishing safe and sustainable banking relationships, leveraging partnerships for banking access and financial empowerment, growing customer relationships, and building long-term loyalty among diverse customers.<br>See https://fdic.gov/news/news/press/2017/pr17030.html |
| **FDIC Announces a New Resource for Community Banks: *Affordable Mortgage Lending Guide, Part III: Federal Home Loan Banks* (FIL-16-2017/ PR-29-2017, April 6, 2017)** | The FDIC published a new guide to help community bankers learn more about the programs and products offered by Federal Home Loan Banks to facilitate mortgage lending. The *Affordable Mortgage Lending Guide, Part III: Federal Home Loan Banks* provides general information about the Affordable Housing Program and the Community Investment Program and serves as a resource for community banks to gain an overview of a variety of products, understand CRA implications, and identify the next steps to initiate or expand mortgage lending. The three parts of the guide can be downloaded at https://fdic.gov/consumers/community/mortgagelending.<br>See https://fdic.gov/news/news/financial/2017/fil17016.html |
| **Consolidated Reports of Condition and Income for First Quarter 2017 (FIL-15-2017, April 6, 2017)** | The new streamlined FFIEC 051 Call Report is available for use by eligible small institutions, generally those with domestic offices only and total assets of less than $1 billion. The new Call Report is part of an effort by the federal bank regulatory agencies to reduce data reporting requirements and other burdens for small institutions. Eligible institutions have the option to file either the FFIEC 051 or the FFIEC 041 Call Report. The first quarter 2017 Call Reports also incorporate a number of other Call Report revisions that were finalized in mid-2016. The Call Report forms for March 2017 are available on the FFIEC's website at https://www.ffiec.gov/ffiec_report_forms.htm and the FDIC's website at https://www.fdic.gov/callreports.<br>See https://fdic.gov/news/news/financial/2017/fil17015.html |

| Subject | Summary |
| --- | --- |
| **FDIC Highlights Free Financial Education Tools During National Financial Capability Month (PR-27-2017, April 3, 2017)** | The FDIC is highlighting education tools it has developed to help people of all ages build financial knowledge and skills to achieve brighter financial futures. These tools include lesson plans for educators to teach children in all grade levels about banking and financial issues, materials to help adults learn more about how bank accounts work, recently updated materials to help older Americans avoid financial exploitation, and educational resources for small business owners. The FDIC's free financial education resources are available at www.fdic.gov/education.<br>See https://fdic.gov/news/news/press/2017/pr17027.html. |
| **FDIC Releases Report on its Youth Savings Pilot and Launches New Network to Support Youth Savings Collaborations (FIL-13-2017/ PR-25-2017, March 28, 2017)** | The FDIC released a report on its Youth Savings Pilot program, which identifies approaches and lessons learned from combining traditional, classroom-based financial education with the opportunity to open a safe, low-cost savings account. The report provides a framework for creating youth savings programs and opportunities. To access this report or learn more about joining the Youth Banking Network, visit the new Youth Banking resource center at http://www.fdic.gov/youthsavings.<br>See https://fdic.gov/news/news/financial/2017/fil17013.html. |
| **FDIC Announces Meeting of Advisory Committee on Community Banking (PR-24-2017, March 24, 2017)** | The FDIC announced that it will hold a meeting of the Advisory Committee on Community Banking on March 28, 2017. Staff will discuss and provide updates on the FDIC's Community Banking Initiative, *Applying for Deposit Insurance: A Handbook for Organizers of De Novo Institutions*, credit risk trends and supervisory expectations, as well as the Youth Savings Pilot and Symposium.<br>See https://fdic.gov/news/news/press/2017/pr17024.html. |
| **Agencies Complete Resolution Plan Evaluation of 16 Domestic Firms and Provide Resolution Plan Guidance to Four Foreign Banking Organizations (PR-23-2017, March 24, 2017)** | The FDIC and the FRB jointly announced that they had completed their evaluation of the 2015 resolution plans of 16 domestic banks and separately issued guidance to four foreign banks. Resolution plans, commonly known as living wills, are required under the Dodd-Frank Act and must describe the company's strategy for a rapid and orderly resolution under bankruptcy in the event of material financial distress or failure of the company. For foreign banking organizations, resolution plans are focused on their U.S. operations.<br>See https://fdic.gov/news/news/press/2017/pr17023.html. |
| **Banking Agencies Issue Joint Report to Congress Under the Economic Growth and Regulatory Paperwork Reduction Act of 1996 (PR-22-2017, March 21, 2017)** | Member agencies of the FFIEC issued a joint report to Congress detailing their review of rules that affect financial institutions. The *Economic Growth and Regulatory Paperwork Reduction Act of 1996* requires the federal bank regulatory agencies, along with the FFIEC, to conduct a review of their rules at least every 10 years to identify outdated or unnecessary regulations. The review focused on the effect of regulations on smaller institutions, such as community banks and savings associations. The report describes several joint actions planned or taken by the agencies, including simplifying capital rules for community banks and savings associations, and increasing the appraisal threshold for commercial real estate loans.<br>See https://fdic.gov/news/news/press/2017/pr17022.html. |

# Regulatory and Supervisory Roundup

continued from pg. 35

| Subject | Summary |
|---|---|
| **FDIC Enhances Tool to Prevent Elder Financial Exploitation (PR-21-2017, March 13, 2017)** | The FDIC announced enhancements to its *Money Smart for Older Adults* curriculum that provide new information and resources to help older adults and their caregivers avoid financial exploitation through fraud and scams. Also included is information on how older adults can plan for a secure financial future and make informed financial decisions.<br>See https://fdic.gov/news/news/press/2017/pr17021.html. |
| **Supervisory Insights Journal Winter 2016 Issue Now Available (FIL-12-2017/ PR-20-2017, March 7, 2017)** | The FDIC issued "Credit Risk Trends and Supervisory Expectation Highlights" in the Winter 2016 issue of *Supervisory Insights*. This article examines growth on bank balance sheets and identifies trends in credit risk in commercial real estate, agriculture, and oil and gas-related lending. The article describes longstanding supervisory expectations for prudent risk management practices regarding credit concentrations within these economic sectors.<br>See https://fdic.gov/news/news/financial/2017/fil17012.html. |
| **FDIC Encourages Consumers to Save Automatically to Achieve Financial Goals (PR-15-2017, February 24, 2017)** | The FDIC encourages consumers to commemorate *America Saves Week* by taking advantage of automatic savings to achieve financial goals. Over time, small automatic deposits into a retirement or savings account can add up with compounded interest, helping consumers cover unexpected expenses and build wealth.<br>See https://fdic.gov/news/news/press/2017/pr17015.html. |
| **FRB and OCC Issue Guidance Explaining How Supervisors Should Examine for Compliance with the Swap Margin Rule (PR-13-2017, February 23, 2017)** | The FRB and the OCC issued guidance explaining how supervisors should examine for compliance with the swap margin rule, which establishes margin requirements for swaps not cleared through a clearinghouse. The guidance explains that the FRB and the OCC expect swap entities covered by the rule to prioritize compliance efforts surrounding the March 1, 2017, variation margin deadline according to the size and risk of their counterparties. Compliance with counterparties that present significant credit and market risk is expected to be in place on March 1, 2017. For other counterparties that do not present significant credit and market risks, the OCC and the FRB expect swap entities to make good faith efforts to comply with the final rule in a timely manner, but no later than September 1, 2017.<br>See https://fdic.gov/news/news/press/2017/pr17013.html. |
| **Banker Webinar on the New Consolidated Reports of Condition and Income for Small Institutions and Other Call Report Revisions Scheduled for March 8 (FIL-10-2017, March 2, 2017, and FIL-11-2017, March 3, 2017)** | On March 8, 2017, the federal bank regulatory agencies will conduct a webinar for bankers to introduce the new FFIEC 051 Call Report, explain its content and how it differs from the existing FFIEC 041 Call Report, and summarize the revisions to the FFIEC 031 and FFIEC 041 Call Reports. The agencies are implementing a new streamlined FFIEC 051 Call Report for eligible small institutions (with domestic offices only and less than $1 billion in total assets), effective March 31, 2017, as part of the FFIEC's efforts to reduce data reporting and other burdens for small financial institutions.<br>See https://fdic.gov/news/news/financial/2017/fil17010.html<br>and https://fdic.gov/news/news/financial/2017/fil17011.html. |

| Subject | Summary |
| --- | --- |
| **FDIC Issues Revised Economic Scenarios for 2017 Stress Testing (PR-12-2017, February 10, 2017)** | The FDIC today released revised economic scenarios for use by certain financial institutions with total consolidated assets of more than $10 billion for the 2017 stress tests. The previously released scenarios contained incorrect historical values for the BBB corporate yield during 2016.<br>See https://fdic.gov/news/news/press/2017/pr17012.html. |
| **FDIC Releases Economic Scenarios for 2017 Stress Testing (PR-11-2017, February 6, 2017)** | The FDIC released the economic scenarios that will be used by certain financial institutions with total consolidated assets of more than $10 billion for stress testing required under the Dodd-Frank Act. The baseline, adverse, and severely adverse scenarios include key variables that reflect economic activity, including unemployment, exchange rates, prices, income, interest rates, and other salient aspects of the economy and financial markets. The FDIC coordinated with the other two federal bank regulatory agencies in developing and distributing these scenarios.<br>See https://fdic.gov/news/news/press/2017/pr17011.html. |
| **FDIC Consumer News Answers Common Questions on How to Avoid Financial Mistakes and Protect Your Money (PR-5-2017, January 23, 2017)** | The Winter 2017 edition of *FDIC Consumer News* offers tips for solving and avoiding problems, such as where to go for help if you cannot access funds on your prepaid card, or understanding your options if you are turned down for a checking account. This edition also provides an overview of "EDIE," the FDIC's online tool for estimating deposit insurance coverage.<br>See https://fdic.gov/news/news/press/2017/pr17005.html. |

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