DEPARTMENT of SAVINGS & MORTGAGE LENDING

9TH ANNUAL

THRIFT INDUSTRY DAY

THURSDAY, SEPTEMBER 15, 2016

12:30 – 1:00 Registration

1:00 – 1:15 Welcome Comments
Caroline C. Jones, Commissioner

1:15 – 1:45 Spotlight on the Industry
Jonathan Finley, Chief Supervisory Analyst, TDSML

1:45 - 2:15 Hot Topics
Patsy Smith, CPA, Deputy Commissioner

2:15 – 2:25 Qualified Thrift Lender
Jan Florez, Senior Thrift Examiner

2:25 – 3:00
Sanjay Bhasin
President and CEO FHLB Dallas

3:00 – 3:15 Break

3:15 – 3:30 Updates-Cybersecurity and ETS
Susanna Blevins, CFE, Supervisory Examiner

3:30 – 3:45 Shared Services
Andrea Henderson, CEIC Examiner

3:45 – 4:00 Compliance Update
Bill Poe, Supervisory Compliance Examiner, CSME

4:00 – 4:30 CECL
Stephany Trotti, CPA, Chief Thrift Examiner

4:30 – 5:00 Q & A and Adjournment
Caroline C. Jones, Commissioner

Spotlight on the Industry

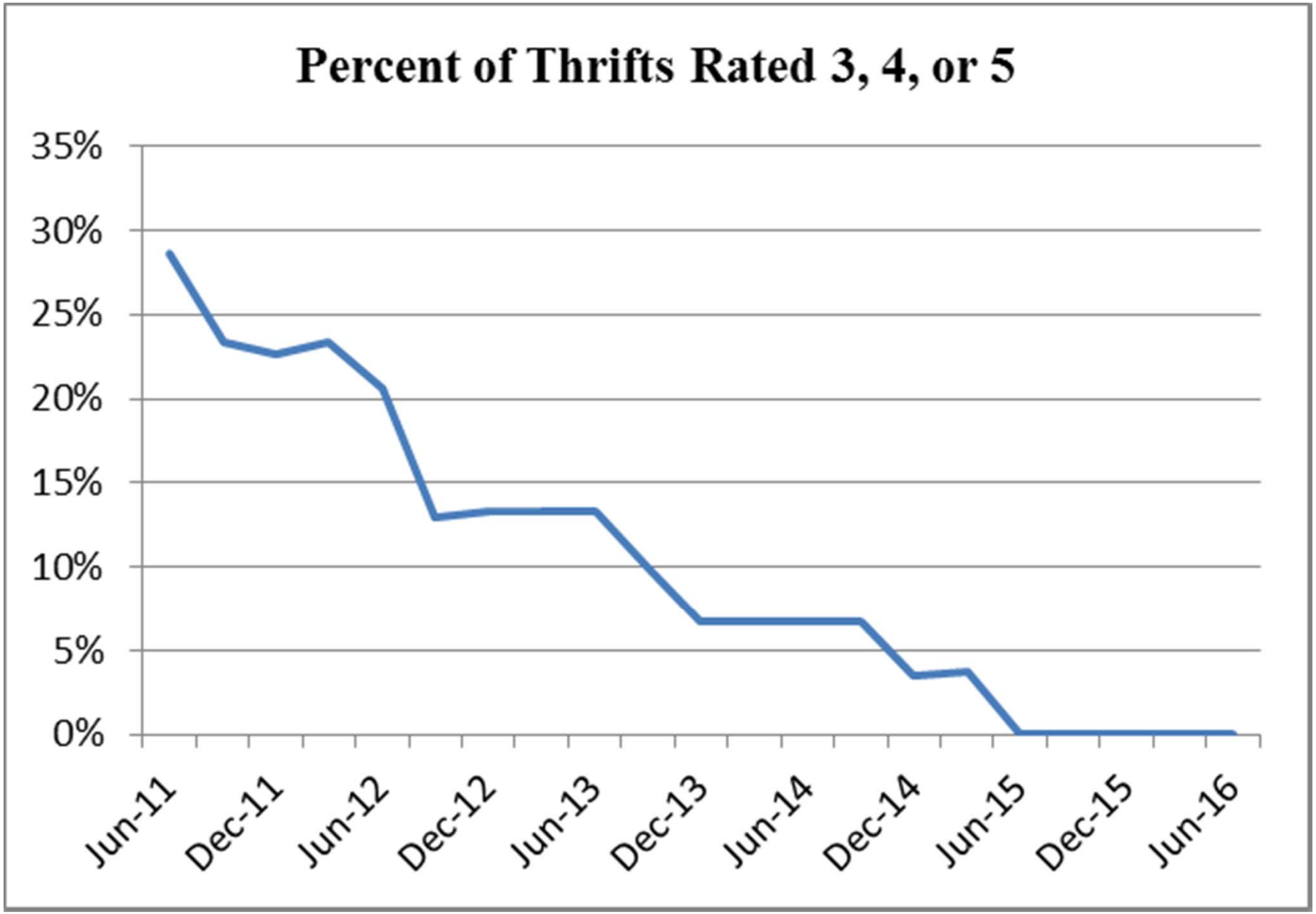
Jonathan D. Finley

Chief Supervisory Analyst

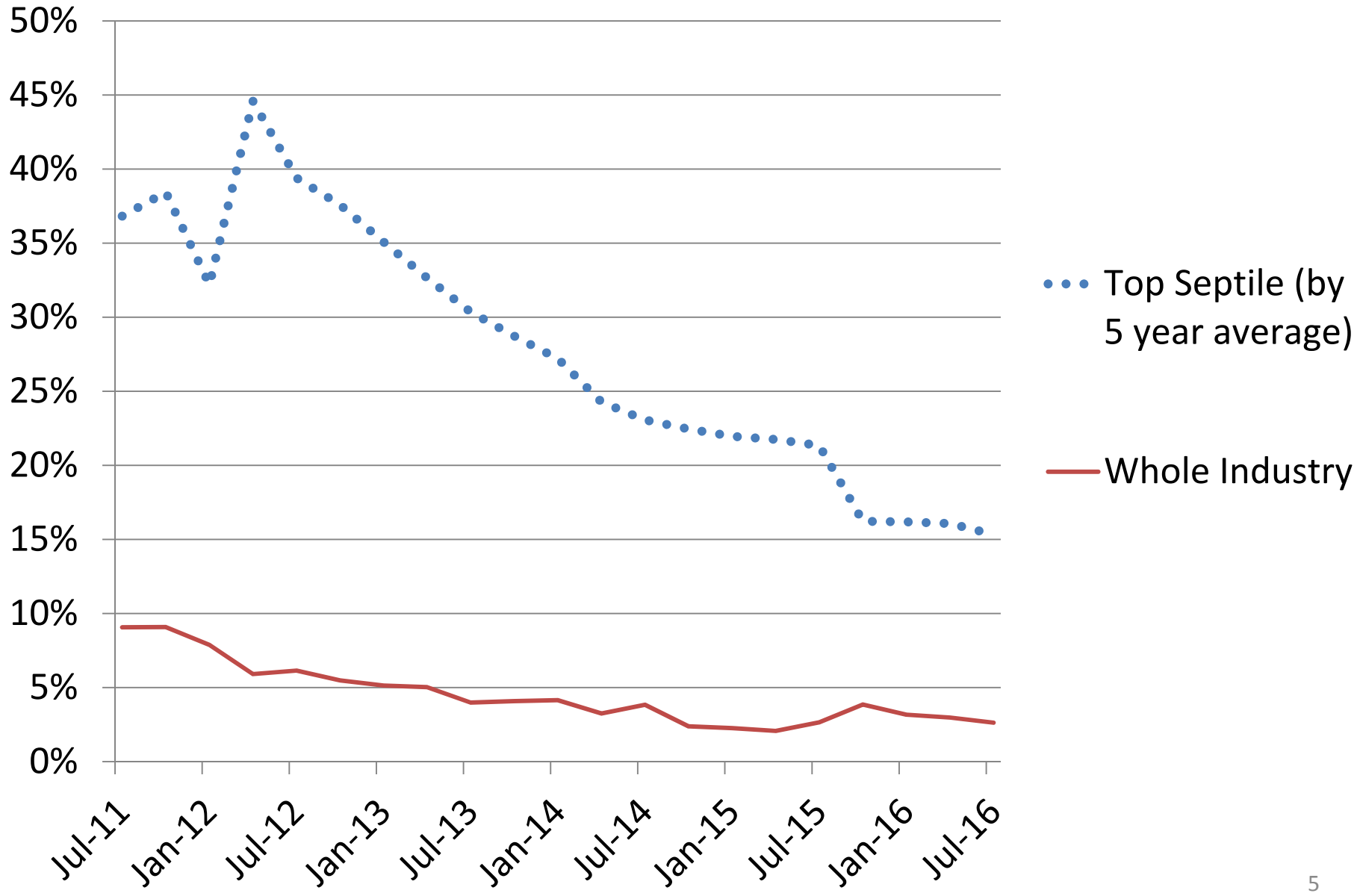
General Industry Data

As of July 1, 2016

- $16.4 billion in assets, growing 39% in the last 12 months!
- Median:
  - Net Interest Margin is 4.0%
  - Georgia (f.k.a. “Texas”) Ratio is 2.6%
  - Leverage Ratio is 10.6%
  - Total Risk-Based Capital Ratio is 15.4%


Percent of Thrifts Rated 3, 4, or 5
35%
30%
25%
20%
15%
10%
5%
0%
Jun-11
Dec-11
Jun-12
Dec-12
Jun-13
Dec-13
Jun-14
Dec-14
Jun-15
Dec-15
Jun-16

Georgia Ratio



Stand Out Issues Q2, 2016

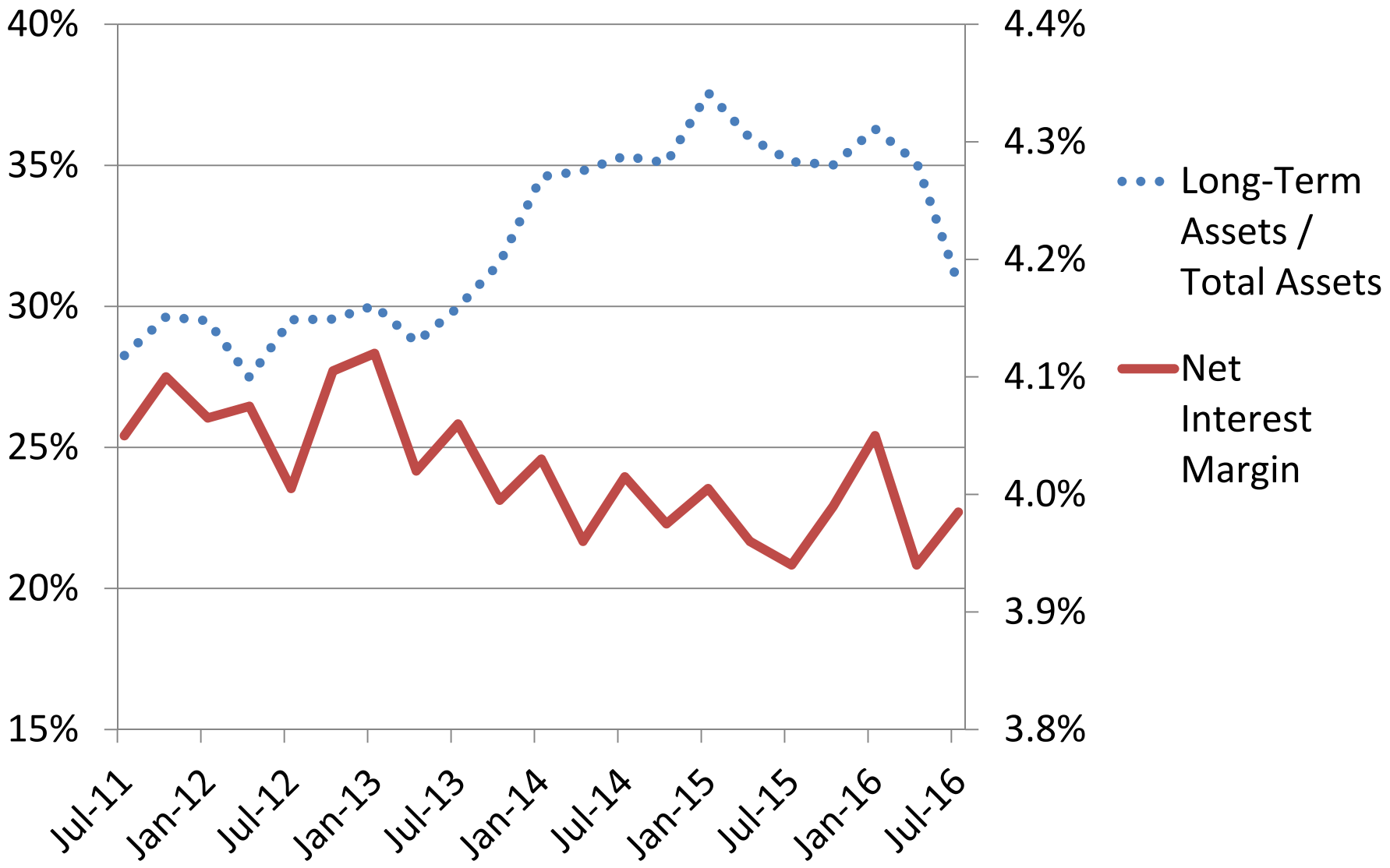
- Fairly Consistent Across Industry
  - Interest Rate Risk
  - Loan-to-Deposit Ratio
  - Total Risk-Based Capital Ratio
- Isolated to a Few Charters
  - Asset Growth
  - Commercial/Industrial Concentrations
  - Growth in Agriculture &/or Ag Land Lending

Trivia

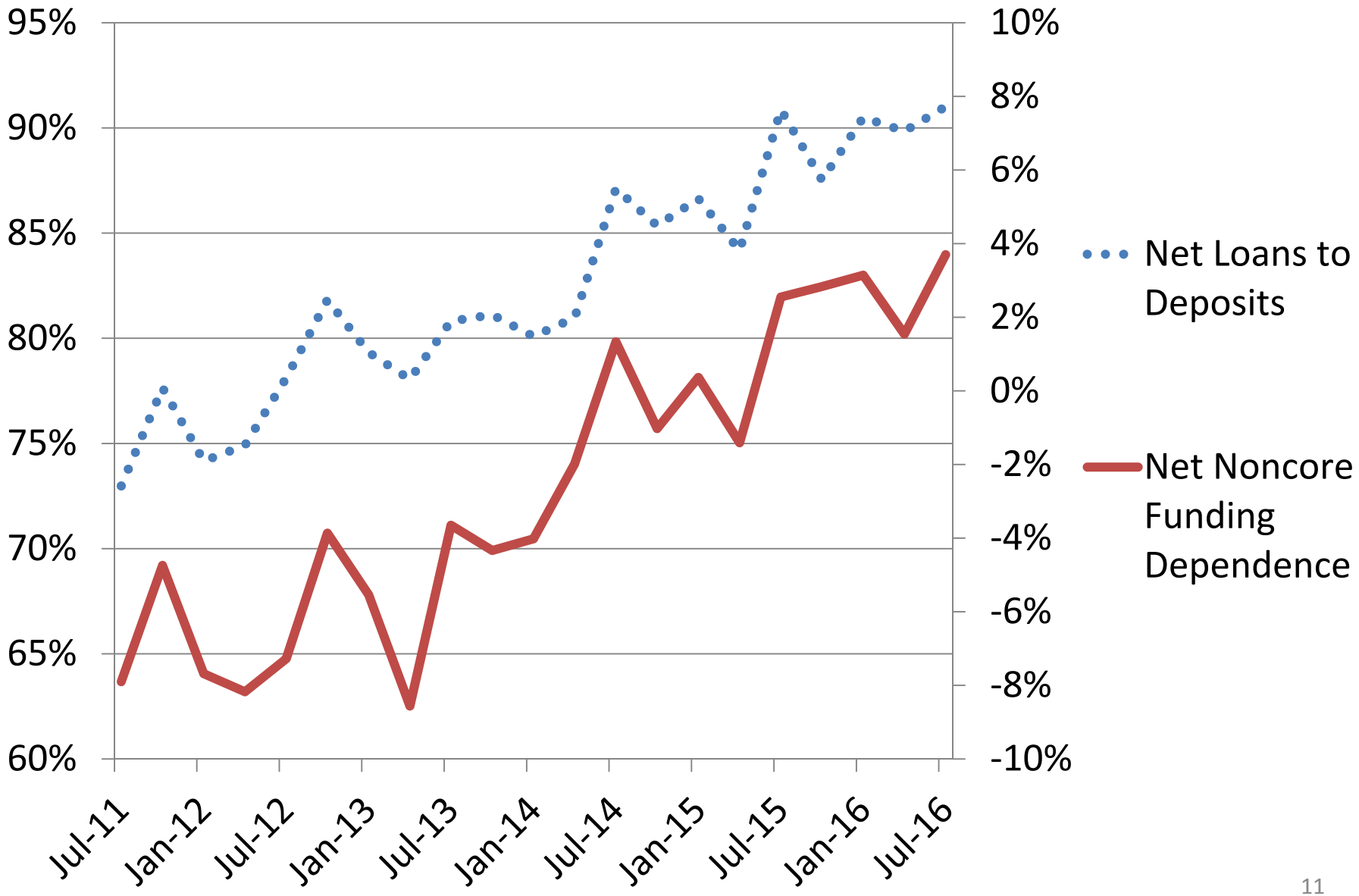
According to Freddie Mac, in what year were "primary 30-year mortgage rates" last in double-digits (averaging 10% or higher)?

1990

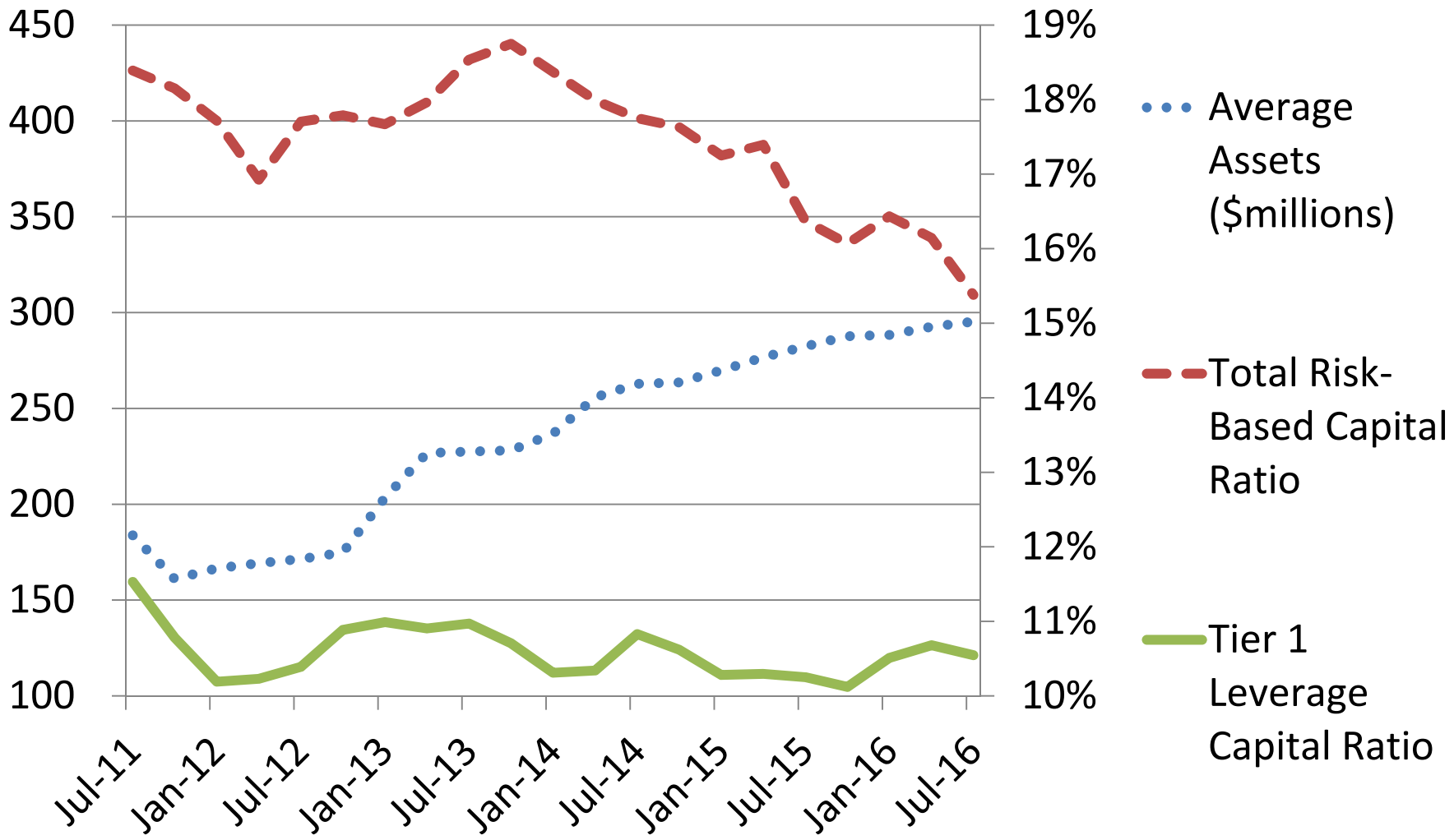
Long-Term Assets & NIM



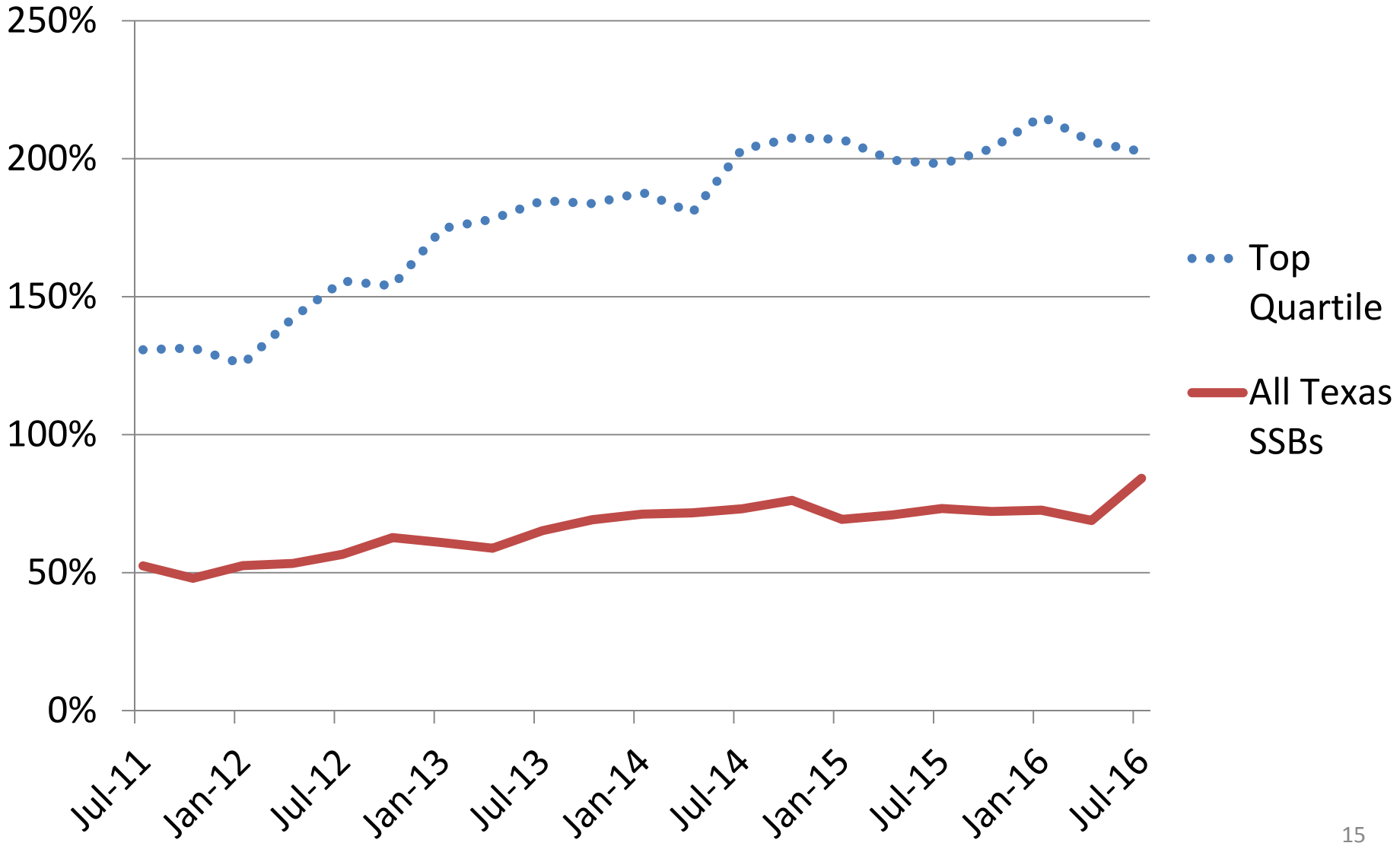
Liquidity Risk



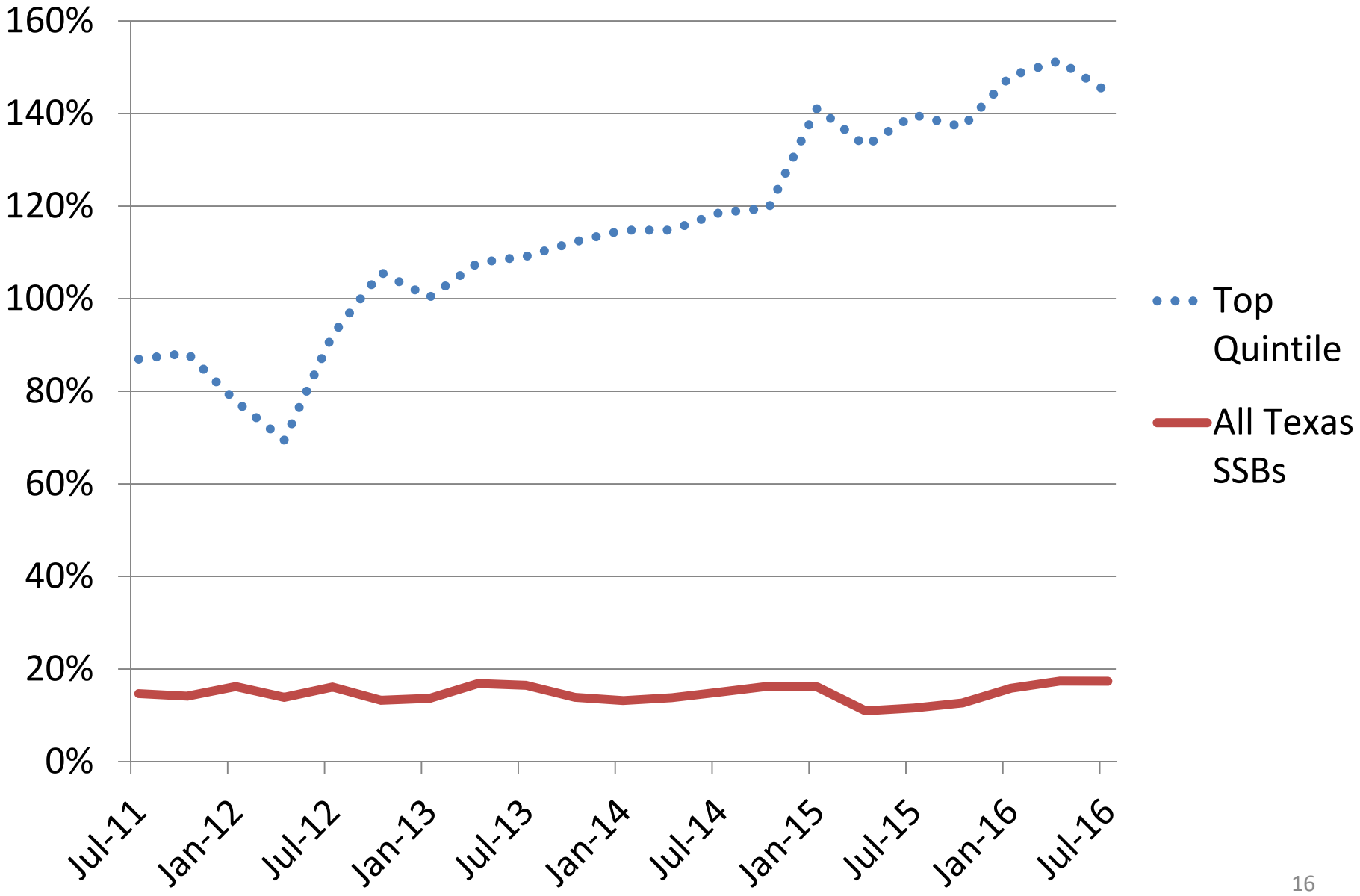
Asset Growth & Risk Leverage



Commercial Loan Concentration (% Total Capital)



Ag & Ag Land Concentration

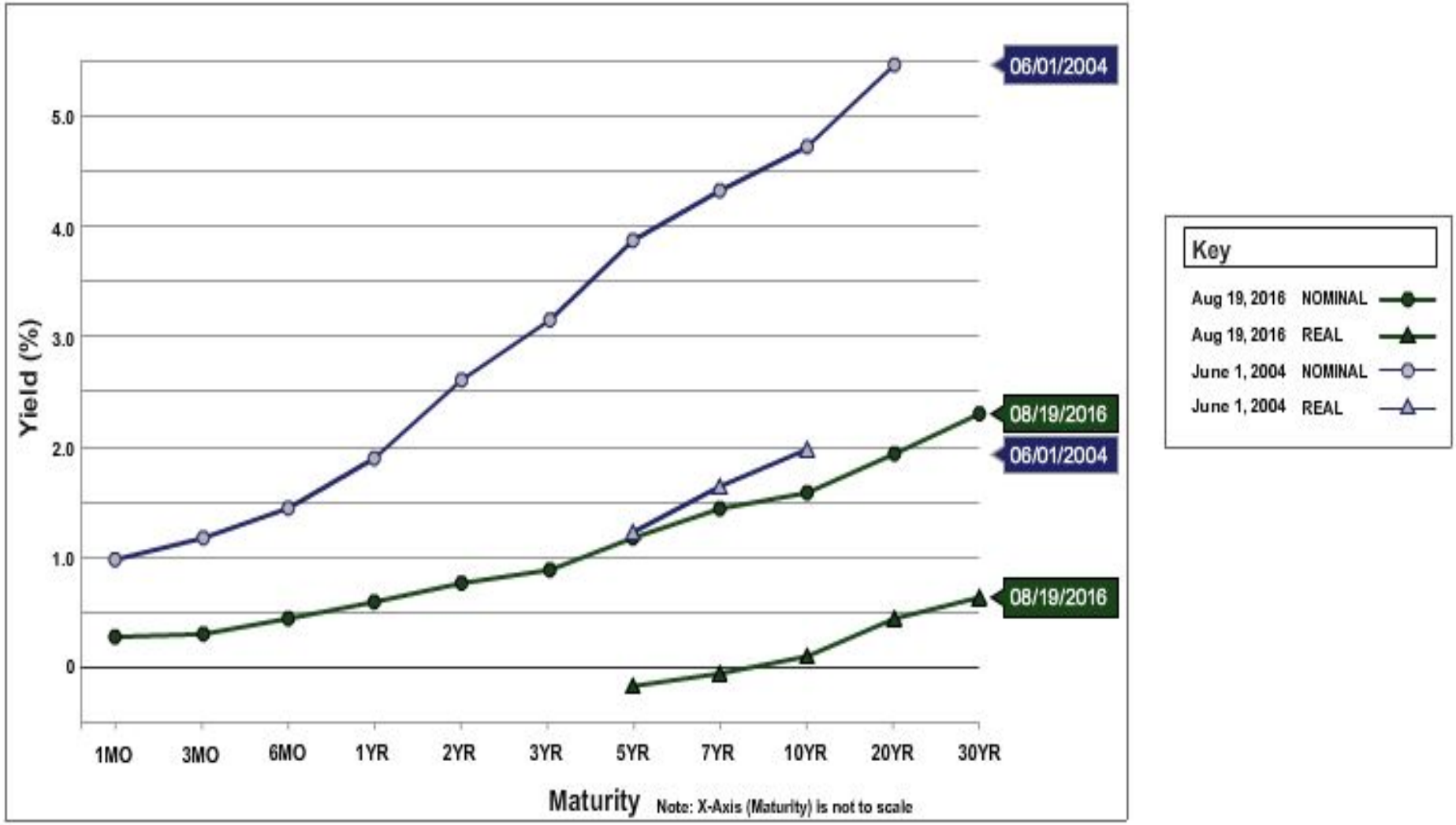


Most Effective Strategies to Stay off the Radar

- Controlled Concentration Risk (Constr., CRE, C&I)
- Strong Management Rating / No Enforcement Actions
- Strong Capital Ratios & Controlled Growth
- Low Adverse Classification and Nonperforming Ratios
- Balanced/Planned Funds Management
- Strong Core Earnings (NIM & Efficiency)

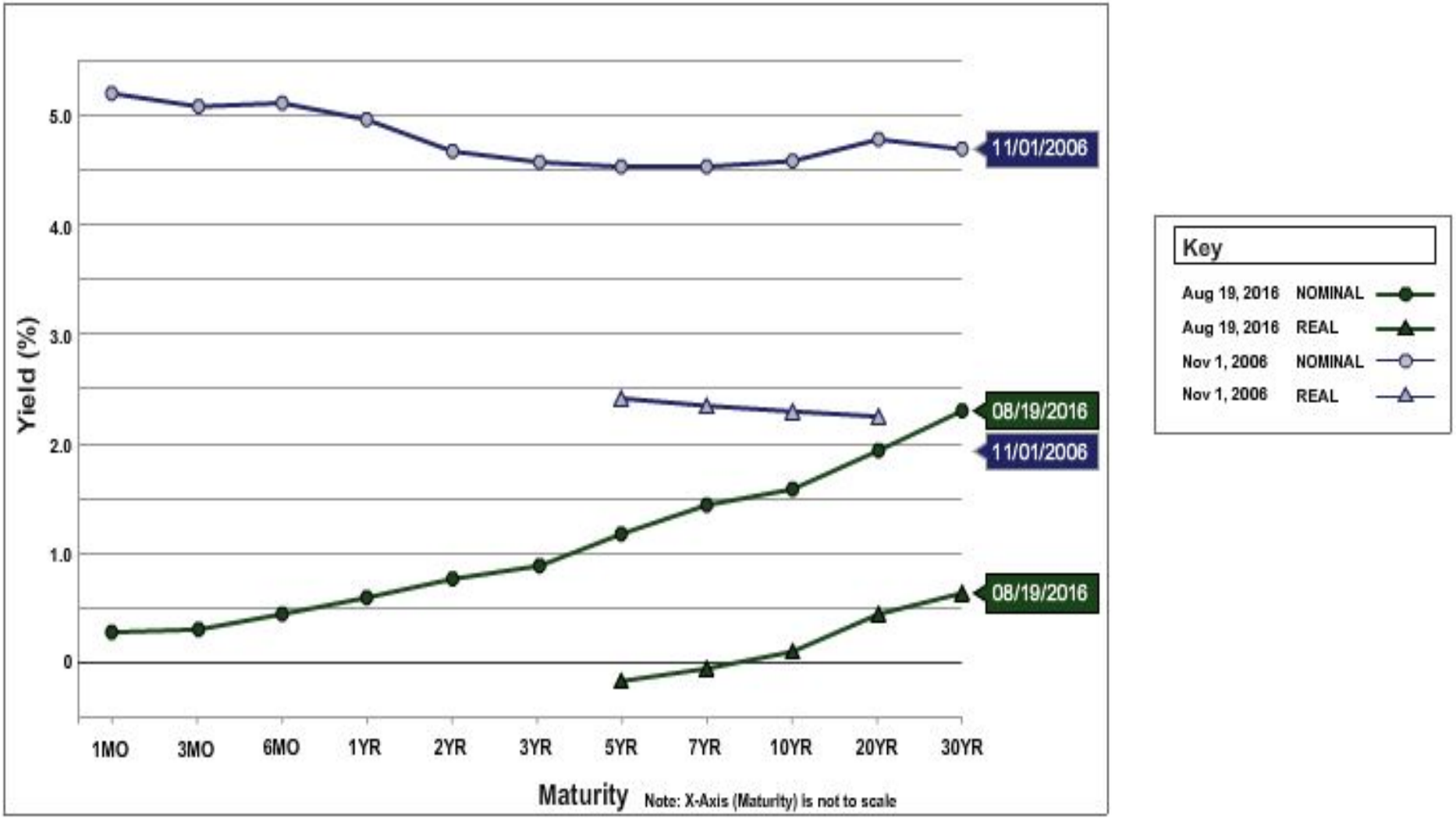
Treasury Yield Curve

June 1, 2004



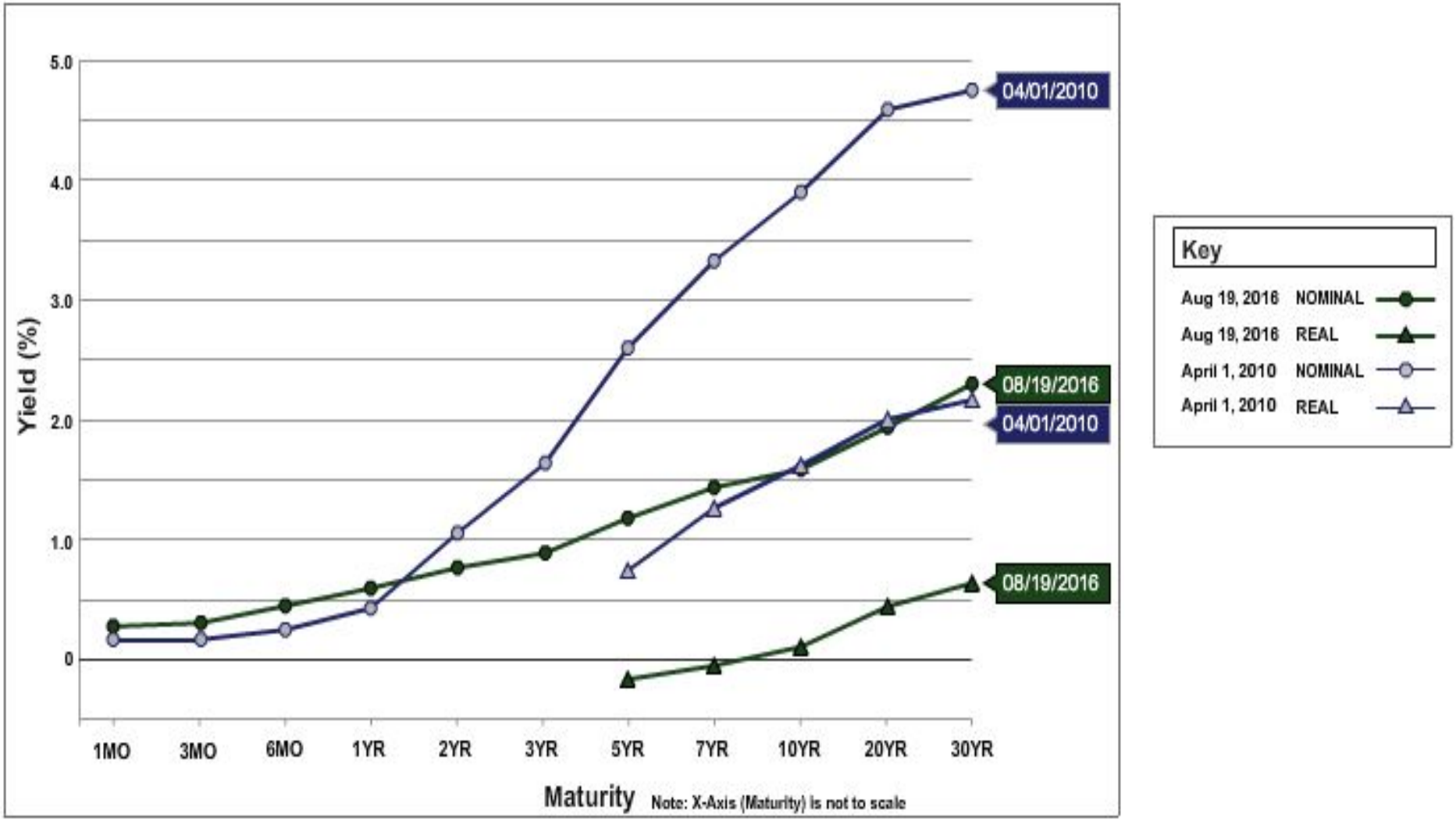
Treasury Yield Curve

November 1, 2006



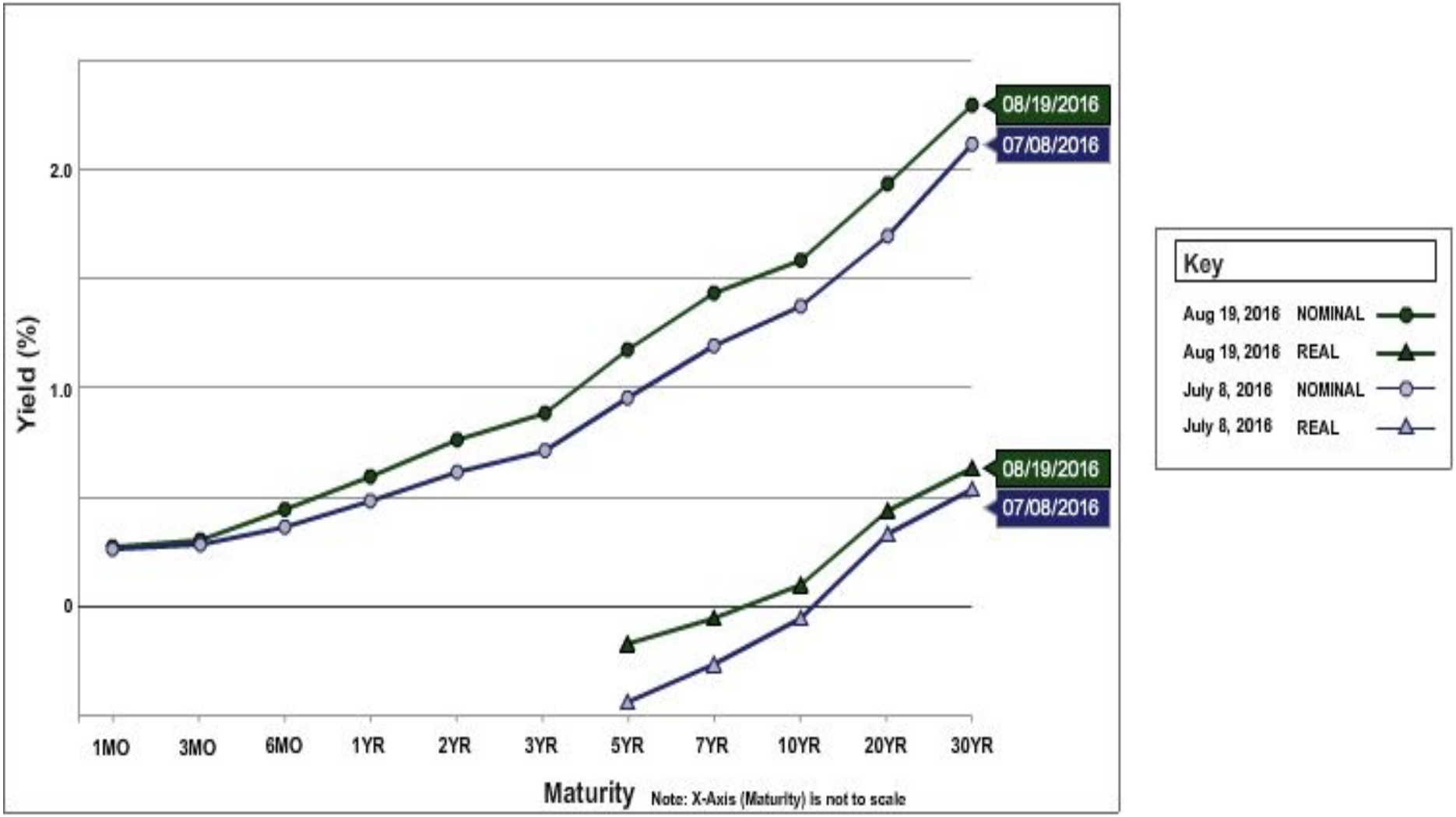
Treasury Yield Curve

April 1, 2010



Treasury Yield Curve

July 8, 2016



Questions? Comments? Discussion?

Jonathan D. Finley

Chief Supervisory Analyst

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BE ON TARGET

Regulatory Hot Topics

Patsy Smith, Deputy Commissioner

September 15, 2016

By **Texas Department of Savings and Mortgage Lending**

ON TARGET

Regulatory Hot Topics

- Concentrations of Credit
- Interest Rate Risk
- Cybersecurity
- CECL

ON TARGET

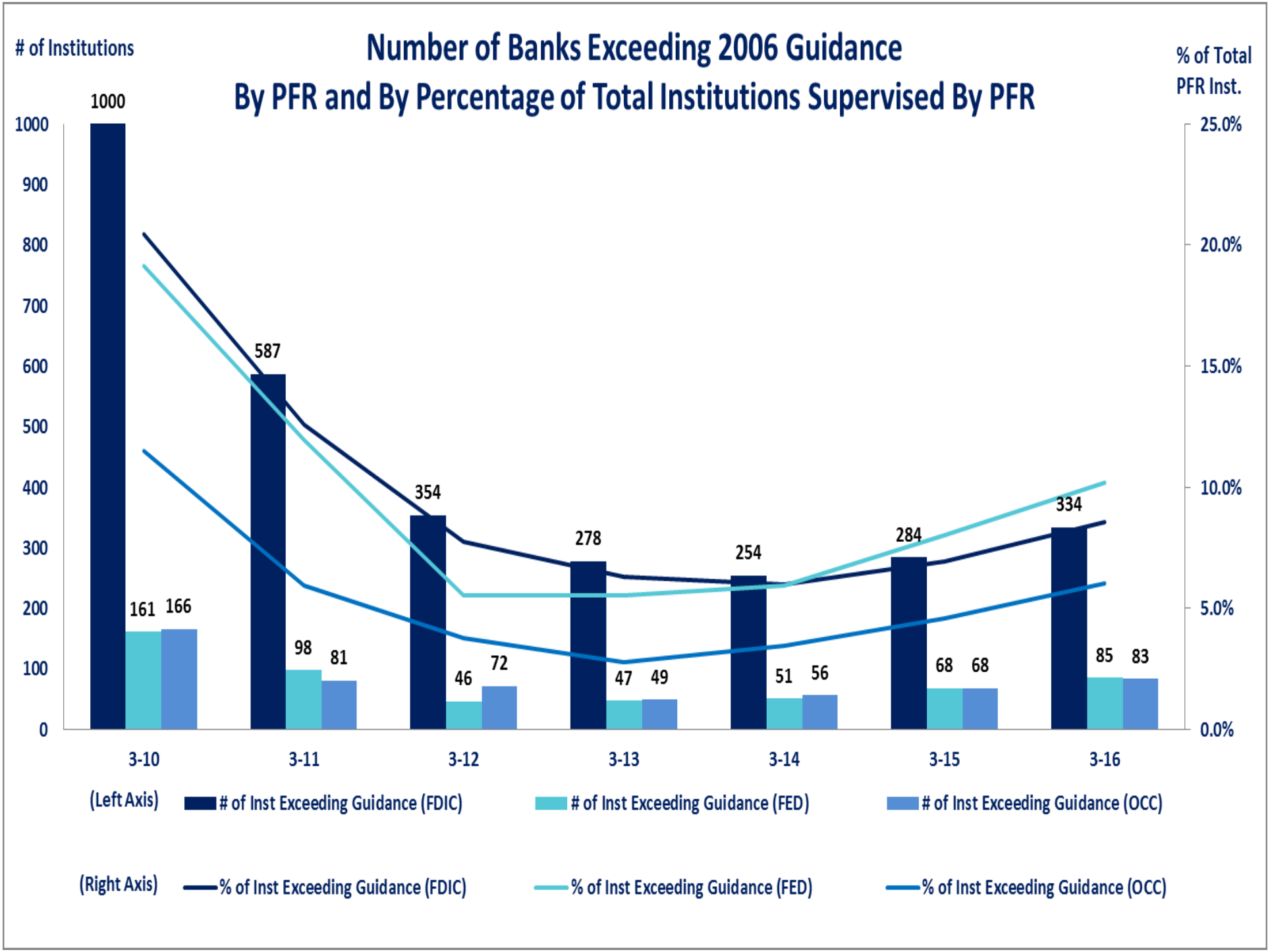
Regulatory Hot Topics

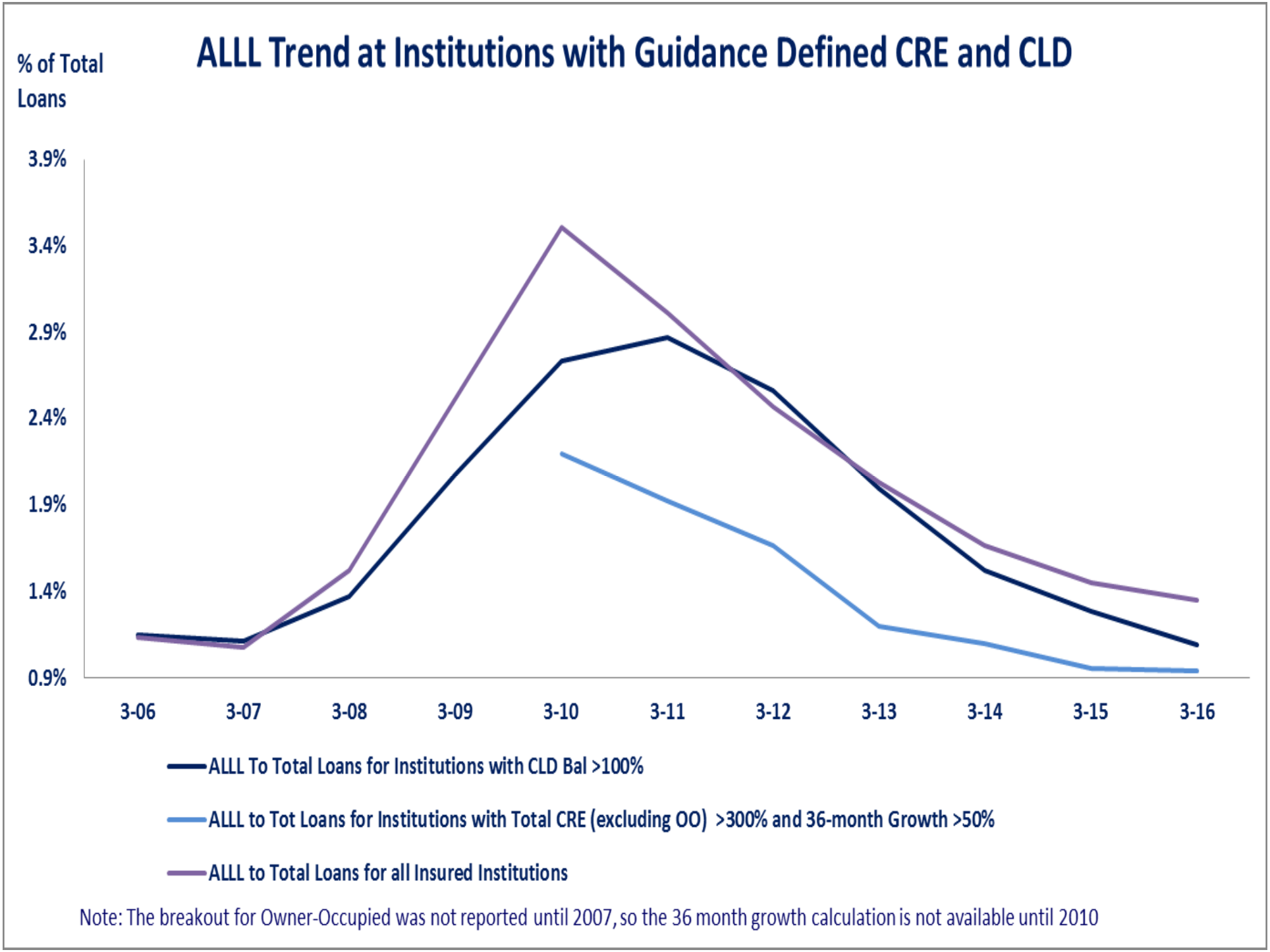
- FinTech
- EGRPRA
- Oil and Gas Work program Findings
- Other Areas of Concern

ON TARGET

Concentrations of Credit

- Recent Growth
- Institutions Exceeding the CRE Guidance Thresholds Have Slightly Lower Loan Loss Allowance Levels than the General Population
  - New Work program being developed similar to oil and gas work program


Number of Banks Exceeding 2006 Guidance
By PFR and By Percentage of Total Institutions Supervised By PFR
# of Institutions
% of Total PFR Inst.
1000
900
800
700
600
500
400
300
200
100
0
25.0%
20.0%
15.0%
10.0%
5.0%
0.0%
1000
161
166
587
98
81
354
46
72
278
47
49
254
51
56
284
68
68
334
85
83
3-10
3-11
3-12
3-13
3-14
3-15
3-16
(Left Axis)
# of Inst Exceeding Guidance (FDIC)
# of Inst Exceeding Guidance (FED)
# of Inst Exceeding Guidance (OCC)
(Right Axis)
% of Inst Exceeding Guidance (FDIC)
% of Inst Exceeding Guidance (FED)
% of Inst Exceeding Guidance (OCC)



Note: The breakout for Owner-Occupied was not reported until 2007, so the 36 month growth calculation is not available until 2010

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Interest Rate Risk

- **Long-term Asset Exposures have risen**
- **Balance Sheets are longer**
- **Most Common IRR pitfalls**

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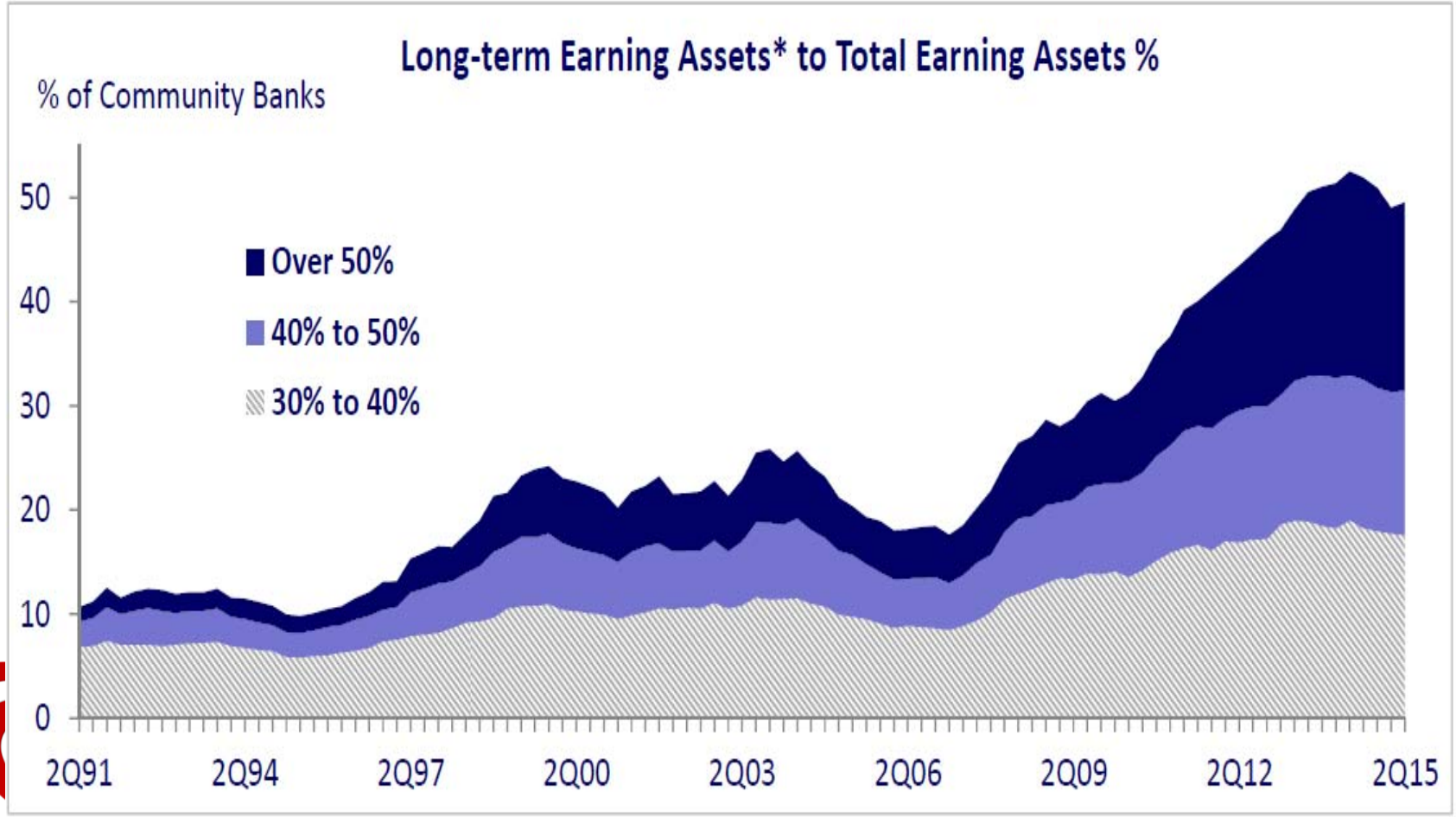
Long-term Asset Exposures have Risen



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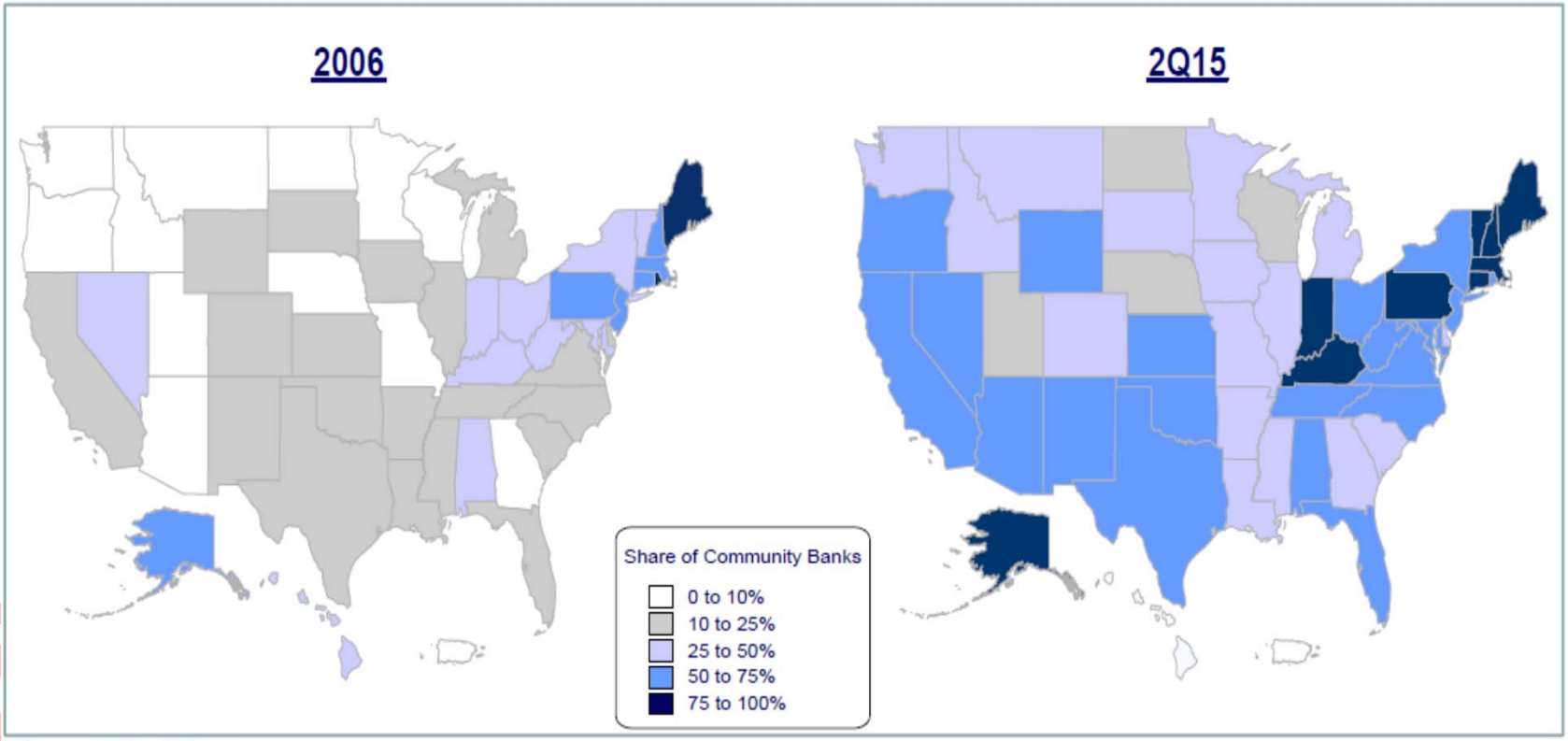
Balance Sheets are Longer

Share of Banks with Long-term Assets Representing 30% or More of Earning Assets



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Most Common IRR Pitfalls

- Unsupported assumptions
- Lack of independent reviews
- Inadequate policy parameters
- Policy exceptions not documented or approved

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Cybersecurity

- Internal monitoring
- Self Assessment Tool – voluntary, but highly recommended by TDSML
- If not completed by bank, examiners will review the internal risk assessment
- Recommendations will be made based on either the completed Self Assessment Tool or internal risk assessment
- New work program – InTREx, FIL 43-2016

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CECL

- Current Expected Credit Loss
- Prepare now
- Presentation to follow by Chief Thrift Examiner Stephany Trotti

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Financial Technology
FinTech

- **The FinTech movement is a significant threat to the traditional banking industry**
- **FinTech Advantages**
- **Bank Advantages**

PREPARE FOR THE FUTURE

ON TARGET

FinTech Advantages

- **Not saddled with extensive branch networks or legacy IT systems resulting in substantially lower operating costs and customer acquisition costs.**
- **Little or no regulation on non-bank side, further driving down costs and freeing them to test new products.**
- **Leveraging this generation's distrust of the banking industry borne from memories of millennials' parents losing jobs and facing foreclosure.**
- **Actively utilizing technology and big data to design superior customer-centric platforms and automated credit decisioning to provide efficient and high-speed experience for the growing number of Generation Y "On-Demand" economy participants.**

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Bank Advantages

- **Existing customer base and the fact that checking accounts remain sticky, at least for now. The complexity in moving bank accounts provides some insulation for incumbents.**
- **The rich source of data you have on your customers. This will be vital in building new products and decisioning systems.**
- **Existing barriers to entry. The chartering process for new banks is complex, uncertain, and requires substantial capital. A bank charter brings more scrutiny, but it also ensures a lower cost of funds, access to FHLB and FRB discount window and payment system, and federal deposit insurance.**

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EGRPRA

- Economic Growth and Regulatory Paperwork Reduction Act Efforts
- Staff serves on CSBS committees
- Changes emerging from EGRPRA process:
  - Higher asset threshold for 18-month exam cycle;
  - Work on streamlined Call Report
  - Capital Simplification=Streamlined Call Report

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Oil and Gas Work program Results

- **Most frequently cited areas needing improvement:**

  lending policies,

- **allowance for loan and lease losses methodology, and**

- **indirect exposure tracking.**

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Other Areas of Concern

- Repeat ROE recommendations
- Non core/volatile funding concerns
- Liquidity contingency weaknesses
- Stress testing deficiencies
- Reg O, 23A and 23B violations

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Exam Common Pitfalls & Solutions

- Not addressing all recommendations
- Untimely completion
- Lack of appropriate approval and/or review documentation in minutes
- Repeat Criticisms
- Waiting until the last minute to address

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Reference Tools

- FDIC website
- FFIEC
- FRB

ON TARGET

Information of Interest

- FILs since July 2015
- FDIC Resource Center – Technical Assistance Video Program

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Questions and Answers

contact info: psmith@sml.texas.gov

FINANCIAL INSTITUTION LETTERS
July 1, 2015 through August 31, 2016

2016

August

- FIL-58-2016 Changes to Deposit Insurance Assessments
- FIL-57-2016 Supervisory Insights Journal: Summer 2016 Issue Now Available
- FIL-56-2016 Ability-to-Repay and Qualified Mortgages Rule Videos Updated
- FIL-55-2016 Proposed New Consolidated Reports of Condition and Income for Small Institutions
- FIL-54-2016 Regulatory Relief: Guidance to Help Financial Institutions and to Facilitate Recovery in Areas of Louisiana Affected by Severe Storms and Flooding
- FIL-53-2016 Proposed New Consolidated Reports of Condition and Income (Call Report) for Eligible Small Institutions and Other Proposed Call Report Revisions

July

- FIL-52-2016 FDIC Seeks Comment on Bank Appeals Guidelines
- FIL-51-2016 Reminder on FDIC Examination Findings
- FIL-50-2016 FDIC Seeking Comment on Proposed Guidance for Third-Party Lending
- FIL-49-2016 Prudent Risk Management of Oil and Gas Exposures
- FIL-48-2016 Consolidated Reports of Condition and Income
- FIL-47-2016 Consolidated Reports of Condition and Income for Second Quarter 2016
- FIL-46-2016 Technical Assistance Video on Corporate Governance
- FIL-45-2016 Consolidated Reports of Condition and Income
- FIL-44-2016 Revisions to the Consolidated Reports of Condition and Income (Call Report)

June

- FIL-43-2016 Information Technology Risk Examination (InTREx) Program
- FIL-42-2016 Frequently Asked Questions on Identifying, Accepting and Reporting Brokered Deposits
- FIL-41-2016 Regulatory Relief: Guidance to Help Financial Institutions and to Facilitate Recovery in Areas of West Virginia Affected by Severe Storms, Flooding, Landslides, and Mudslides
- FIL-40-2016 Proposed Rulemaking to Remove References to Credit Ratings from the FDIC's International Banking Regulations
- FIL-39-2016 Joint Statement on the New Accounting Standard on Financial Instruments - Credit Losses
- FIL-38-2016 Regulatory Relief: Guidance to Help Financial Institutions and to Facilitate Recovery in Areas of Texas Affected by Severe Storms and Flooding

- FIL-37-2016 FFIEC Joint Statement on Cybersecurity of Interbank Messaging and Wholesale Payment Networks

May

- FIL-36-2016 Summary of Deposits Survey: Filing for June 30, 2016
- FIL-35-2016 Interagency Guidance: Deposit-Reconciliation Practices
- FIL-34-2016 Incentive-Based Compensation Arrangements: Interagency Notice of Proposed Rulemaking
- FIL-33-2016 Net Stable Funding Ratio: Proposed Rule
- FIL-32-2016 Request for Comments on Mobile Financial Services Strategies and Participation in Economic Inclusion Demonstrations

April

- FIL-31-2016 Mobile Financial Services: Update to FFIEC IT Examination Handbook Series
- FIL-30-2016 Updated Financial Institution Employee's Guide to Deposit Insurance
- FIL-29-2016 Regulatory Relief: Guidance to Help Financial Institutions and to Facilitate Recovery in Areas of Texas Affected by Severe Storms and Flooding
- FIL-28-2016 Small Bank Pricing: Final Rule
- FIL-27-2016 Regulatory Relief: Guidance to Help Financial Institutions and to Facilitate Recovery in Areas of Mississippi Affected by Severe Storms and Flooding
- FIL-26-2016 Regulatory Relief: Guidance to Help Financial Institutions and to Facilitate Recovery in Areas of Texas Affected by Severe Storms, Tornadoes and Flooding
- FIL-25-2016 Consolidated Reports of Condition and Income
- FIL-24-2016 Supplemental Guidance Related to the FDIC Statement of Policy on Applications for Deposit Insurance
- FIL-23-2016 Supervisory Insights Journal: Special Corporate Governance Edition Now Available
- FIL-22-2016 Consolidated Reports of Condition and Income for First Quarter 2016

March

- FIL-21-2016 Bank Secrecy Act: Interagency Guidance to Issuing Banks on Applying Customer Identification Program Requirements to Holders of Prepaid Cards
- FIL-20-2016 Regulatory Relief: Guidance to Help Financial Institutions and to Facilitate Recovery in Areas of Louisiana Affected by Severe Storms and Flooding
- FIL-19-2016 Technical Assistance Video on Outsourcing Technology Services
- FIL-18-2016 Flood Insurance Videos Updated

FINANCIAL INSTITUTION LETTERS
July 1, 2015 through August 31, 2016

- FIL-17-2016 Examination Cycle: Joint Interim Final Rules and Request for Comments on Expanded Examination Cycle for Certain Small Insured Depository Institutions and U.S. Branches and Agencies of Foreign Banks

- FIL-16-2016 Supervisory Expectations for Evaluations

- FIL-15-2016 Capital Treatment for Qualifying Collateralized Debt Obligations Backed by Trust Preferred Securities under the "Volcker Rule"

- FIL-14-2016 Discontinuation of Foreclosure Proceedings

- FIL-13-2016 FDIC Announces Webinar for National Consumer Protection Week 2016: Cybersecurity Resources for Financial Institution Customers

- FIL-12-2016 Interagency Guidance on Funds Transfer Pricing Related to Funding and Contingent Liquidity Risks

February

- FIL-11-2016 Regulatory Relief: Guidance to Help Financial Institutions and to Facilitate Recovery in Areas of Arkansas Affected by Severe Storms, Tornadoes, Straight-Line Winds, and Flooding

- FIL-10-2016 Interest Rate Risk Videos Updated

- FIL-9-2016 Supervisory Insights Journal: Winter 2015 Issue Now Available

January

- FIL-8-2016 Regulatory Relief: Guidance to Help Financial Institutions and Facilitate Recovery in Areas of Missouri Affected by Severe Storms, Straight-Line Winds, and Flooding

- FIL-7-2016 Small Bank Pricing: Notice of Proposed Rulemaking

- FIL-6-2016 Deposit Insurance Coverage Seminars: Free Nationwide Seminars for Bank Officers and Employees

- FIL-5-2016 Interagency Advisory on External Audits of Internationally Active U.S. Financial Institutions

- FIL-4-2016 FDIC Announces Upcoming Community Affairs Webinar: Savings Strategies During America Saves Week 2016

- FIL-3-2016 Consolidated Reports of Condition and Income

- FIL-2-2016 Consolidated Reports of Condition and Income for Fourth Quarter 2015

- FIL-1-2016 Regulatory Relief: Guidance to Help Financial Institutions and Facilitate Recovery in Areas of Mississippi Affected by Severe Storms, Tornadoes, Straight-Line Winds, and Flooding

2015

December

- FIL-62-2015 Statement on Prudent Risk Management for CRE Lending

- FIL-61-2015 Margin and Capital Requirements for Covered Swap Entities

- FIL-60-2015 Final Rule Amending the Filing Requirements and Processing Procedures for Changes in Control
- FIL-59-2015 Revised Compliance Examination Manual
- FIL-58-2015 Proposed Revisions to the Consolidated Reports of Condition and Income and Banker Teleconference Scheduled for December 8
- FIL-57-2015 Proposed Revisions to the Consolidated Reports of Condition and Income and Banker Teleconference Scheduled for December 8
- FIL-56-2015 Regulatory Relief: Guidance to Help Financial Institutions and Facilitate Recovery in Areas of Texas Affected by Severe Storms, Tornadoes, Straight-Line Winds, and Flooding

November

- FIL-55-2015 Cybersecurity Awareness Resources
- FIL-54-2015 Updated FFIEC Management Booklet Part of IT Examination Handbook Series
- FIL-53-2015 Minimum DIF Reserve Ratio Requirement
- FIL-52-2015 FDIC Clarifying its Approach to Banks Offering Products and Services, such as Deposit Accounts and Extensions of Credit, to Non-Bank Payday Lenders
- FIL-50-2015 Supervisory Guidance on the Capital Treatment of Certain Investments in Covered Funds
- FIL-49-2015 Advisory on Effective Risk Management Practices for Purchased Loans and Purchased Loan Participations

October

- FIL-48-2015 Cybersecurity Awareness Month - Industry Teleconference
- FIL-47-2015 Bank Secrecy Act: Spanish Translation of the 2014 Bank Secrecy Act/Anti-Money Laundering Examination Manual
- FIL-46-2015 Banker Teleconference Series: Timely and Comprehensive Information from the FDIC
- FIL-45-2015 Regulatory Relief: Guidance to Help Financial Institutions and Facilitate Recovery in Areas of South Carolina Affected by Severe Storms and Flooding
- FIL-44-2015 Consolidated Reports of Condition and Income
- FIL-43-2015 Supervisory Expectations for Financial Institutions Implementing the Truth in Lending Act (Regulation Z) and Real Estate Settlement Procedures Act (Regulation X) Integrated Disclosure Rule
- FIL-42-2015 Consolidated Reports of Condition and Income for Third Quarter 2015

September

- FIL-41-2015 Regulatory Relief: Guidance to Help Financial Institutions and Facilitate Recovery in Areas of California Affected by the Valley Fire
- FIL-40-2015 Consolidated Reports of Condition and Income

FINANCIAL INSTITUTION LETTERS
July 1, 2015 through August 31, 2016

- FIL-39-2015 Proposed Revisions to the Consolidated Reports of Condition and Income (Call Report)
- FIL-38-2015 Deposit Insurance Coverage Seminars
- FIL-37-2015 Final Rule: Military Lending Act

August

- FIL-36-2015 Supervisory Insights Journal: Summer 2015 Issue Now Available
- FIL-35-2015 Regulatory Relief: Guidance to Help Financial Institutions and Facilitate Recovery in Areas of Kentucky Affected by Severe Storms, Tornadoes, Straight-line Winds, Flooding, Landslides, and Mudslides
- FIL-34-2015 Regulatory Relief: Guidance to Help Financial Institutions and Facilitate Recovery in Areas That Support the Oglala Sioux Tribe of the Pine Ridge Indian Reservation Affected by Severe Storms, Straight-Line Winds, and Flooding
- FIL-33-2015 Regulatory Relief: Guidance to Help Financial Institutions and Facilitate Recovery in Areas of the Commonwealth of Northern Mariana Islands Affected by Typhoon Soudelor

July

- FIL-32-2015 Issuance of Final Rule on Loans in Areas Having Special Flood Hazards
- FIL-31-2015 Consolidated Reports of Condition and Income
- FIL-30-2015 Consolidated Reports of Condition and Income for Second Quarter 2015
- FIL-29-2015 Banker Teleconference Series: Timely and Comprehensive Information from the FDIC
- FIL-28-2015 Cybersecurity Assessment Tool

Texas State Savings Bank Investment Limit Options

Generalized Investment Limits	State Savings Bank Default Investment Limits (TAC §77.71)	State Commercial Bank Limits (Parity with TFC §34.101)	Federal Savings Institutions (Parity with 12 USC 1464)	National Bank Limits (Parity with 12 CFR 1)
US Treasury	Unlimited	Unlimited	Unlimited	Unlimited
US Agency (issued, sponsored, or guaranteed)	Unlimited	Unlimited	Unlimited	Unlimited
In-State Municipal Securities	Unlimited	Unlimited	10 % of Total Capital per Obligor	Unlimited
Out-of-State Municipal Securities	Requires Commissioner Permission	Unlimited	10% of Total Capital per Obligor	Unlimited
Other Mortgage-Backed Securities	Requires Commissioner Permission	Unlimited	Unlimited	Unlimited
Asset-Backed Securities	Requires Commissioner Permission	15% of Tier 1 Capital per Obligor	No Power Granted	10% of Total Capital per Obligor
Structured Financial Products	Requires Commissioner Permission	15% of Tier 1 Capital per Obligor	No Power Granted	10% of Total Capital per Obligor
Other Permissible Debt Securities	Requires Commissioner Permission	15% of Tier 1 Capital per Obligor	Unlimited	10% of Total Capital per Obligor
FHLB Stock	Unlimited	15% of Tier 1 Capital per Obligor	Unlimited	10% of Total Capital per Obligor
Other Permissible Equity Securities/Mutual Funds	Requires Commissioner Permission	15% of Tier 1 Capital per Obligor	No Power Granted	10% of Total Capital per Obligor

Note: the above represent "per obligor" limitations. Additional portfolio limitations may apply

Qualified Thrift Lender (QTL) Clarifications

Jan Florez
Senior Examiner

Part 1- Portfolio Assets

What Liquid Assets Can Be Reported

Pursuant to 12 USC 1467a(m)(4)(B)(iii), liquid assets for QTL purposes are defined as the types listed in 12 USC 1465 include:

- Cash
- Balances maintained in Federal Reserve banks, Federal Home Loan Banks, and commercial banks
- Obligations of the United States and bankers acceptances
- Liquid, high-quality corporate debt obligations with **three years or less remaining until maturity.**

Part 1- Portfolio Assets

What Liquid Assets Can Be Reported (Con't)

- High-quality commercial paper with **270 days or less remaining until maturity**
- Mortgage-related securities **that have one year or less remaining until maturity or are subject to an agreement to be purchased within one year** by another insured depository institution that is in compliance with applicable capital standards, a primary dealer in U.S. government securities, or a broker or dealer registered under the Securities Exchange Act of 1934

Part 1- Portfolio Assets

What Liquid Assets Can Be Reported (Con't)

- Mortgage loans on the security of a first lien on residential real property, if the mortgage loans qualify as backing for ***mortgage-backed securities*** issued by the Fannie Mae or Freddie Mac or guaranteed by the Ginnie Mae, and either the mortgage loans **have one year or less remaining until maturity, or the mortgage loans are subject to an agreement of purchase by an insured depository institution not to exceed a period of one year**.

Title 12 - BANKS AND BANKING
CHAPTER 12 - SAVINGS ASSOCIATIONS
Sec. 1465 - Liquid asset requirements

§1465. Liquid asset requirements

(a) **In general**

- (ii) **such obligations, including such special obligations, of the United States, a State, any territory or possession of the United States, or a political subdivision, agency, or instrumentality of any one or more of the foregoing, and bankers' acceptances, as the Director may approve;**

Part 1- Portfolio Assets QTL Report Line Items

- Line 1- Total Assets as reported on RC
- Line 2- 20% of TA or line 1
- Line 4-Liquid Assets and cannot exceed Line 2 or 20% of TA

Part 2- Qualified Thrift Investments(QTI) Assets Includable without limit

- Note: For all calculations, use the outstanding principal balance and add accrued interest and premiums; deduct charge-offs, deferred loan fees, loans in process and unearned discounts.

Part 2 QTI – Without Limit Selected Line Items

Line 9 – Mortgage Loans

- Enter loans held that were made to purchase, refinance, construct, improve, or repair domestic residential housing or manufactured housing. Note: The term “domestic” refers to units within the 50 states, the District of Columbia, Puerto Rico, the Virgin Islands, Guam, American Samoa, the Trust Territory of the Pacific Islands, and the Northern Mariana Islands.

Part 2 QTI – Without Limit Selected Line Items

Residential Housing

- For QTL purposes, as defined in 12 CFR 141, residential housing includes residential real estate and dwelling units. Section 141.23 defines residential real estate (or residential real property):
  - Homes (including condominiums and cooperatives).
  - Combinations of homes and business property.
  - **Other real estate used primarily for residential purposes other than a home** (but which may include homes).

Part 2 QTI – Without Limit Selected Line Items

Residential Housing (continued)

- Combinations of such real estate and business property involving only minor business use.
- Farm residences and combinations of farm residences and commercial farm real estate.
- **Property to be improved by the construction of such structures.**
- Leasehold interests in the above real estate.

- Section 141.10 defines dwelling unit as: “The unified combination of rooms designed for residential use by one family, other than a single-family dwelling.”

Part 2 QTI – Without Limit Selected Line Items

Line 12 – Mortgage-Backed Securities

- -Enter securities backed by or representing an interest in domestic residential housing or manufactured housing.
- -FSAs should include securities purchased and exclude securities sold from qualified thrift investments on their trade dates.
- Note: ***This item encompasses mortgage-pool securities, mortgage-pool pass-through securities, mortgage-backed bonds, and mortgage-backed pay-through bonds***. This item also encompasses any derivative mortgage-related security created by disaggregating and repackaging the cash flows received as payments on mortgages and traditional mortgage-pool securities. ***The underlying assets of such securities must be domestic residential housing.***

Part 2 QTI – Without Limit Selected Line Items

Line 12 – Mortgage-Backed Securities (continued)

- ***Bonds, including Federal Home Loan Bank, Freddie Mac, Fannie Mae, and Ginnie Mae bonds, count only if they are backed by mortgages***.

- Do not include as a qualified thrift investment Resolution Funding Corporation (REFCO) bonds.

Part 2 QTI – Without Limit Selected Line Items

Line 14 - Small Business Loans

- The OCC's definition of a small business loan (12 CFR 160.3) is:
- 1. "Small business loans and loans to small businesses include any loan to a small business as defined in this section";
  - a. A small business per 12 CFR 160.3 is defined as a small business concern or entity as defined by section 3(a) of the Small Business Act, 15 U.S.C. 632(a), and implemented by the regulations of the Small Business Administration at 13 CFR part 121.
    - i. Small business administration states that a small business concern must be independently owned and operated and not dominant in its field of operation
    - ii. **And** meet the size standard set forth in 13 CFR 121 (Small Business Size Regulations)
- 2. Or a loan that does not exceed $2 million (including a group of loans to one borrower) and is for commercial, corporate, business, or agricultural purposes.

Part 2 QTI – With 20% Limit Selected Line Items

Line 23 - Community Service Facility Loans (Purchase, Construction, Improvement)

- Community service facilities are churches or other places of worship, schools, nursing homes, hospitals, and facilities serving similar functions within a community.

Resources

- OCC Comptroller's Handbook – Qualified Thrift Lender, November 2013

Jan Florez
Senior Examiner
jflorez@sml.texas.gov
804-200-8161(cell)

Questions?????

DEPARTMENT of SAVINGS & MORTGAGE LENDING

9TH ANNUAL

THRIFT INDUSTRY DAY

THURSDAY, SEPTEMBER 15, 2016

FEATURED GUEST SPEAKER

Sanjay K. Bhasin
President & CEO
Federal Home Loan Bank of Dallas

Sanjay K. Bhasin has served as President and Chief Executive Officer of the Federal Home Loan Bank of Dallas since May 2014. Under his leadership, the value proposition for members has been strengthened through enhanced products, services, and funding solutions. He also serves on the Council of Federal Home Loan Banks, the trade association for the 11 Federal Home Loan Banks.

Prior to joining the Bank, Mr. Bhasin was Executive Vice President, Members and Markets at the Federal Home Loan Bank of Chicago (Chicago Bank). Mr. Bhasin joined the Chicago Bank in 2004 as Vice President, Mortgage Finance, and he was promoted to various leadership roles throughout his tenure.

Prior to joining the Chicago Bank, he was responsible for managing the interest rate risk associated with Bank One, NA's mortgage pipeline holdings from 1999 to 2004.

Mr. Bhasin holds an MBA in Finance from Indiana University.

FHLBANK DALLAS

Member driven.
Community focused.

Texas Department of
Savings and Mortgage Lending

Thrift Industry Day

September, 2016

FHLBANK DALLAS

A FHLB Value Proposition

FHLBANK DALLAS

Benefits of FHLB Membership

Key Differentiators for Members

Optimize Liquidity Management	• Access reliable same-day liquidity that has been proven through many business cycles • Manage unexpected cash outflows through short-term borrowings
Enhance Investment Spread	• Issuance of advances for Asset Liability Management (ALM) and liquidity • Customizable funding to match investment structures
Expand ALM Options	• Stabilize earnings and enhance ALM through accounting-friendly funding structures • Enhance Net Interest Margin (NIM), earnings, and ROE by funding investments
Secondary Mortgage Market	• Competitive secondary mortgage outlet that benefits high quality loans
Hedging Flexibility Through Funding	• FHLB Advances funding can be customized for a variety of fixed or floating rates, options. • Maturities can be short-, medium-, or long-term, and amortizing or with a balloon payment at maturity making them convenient to match duration of various types of assets.

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B Interest Rate Risk Management

Floating-to-Fixed Funding Strategy

How It Works

Combines a Floating-Rate Advance with a Fixed-Rate, Forward-Starting Advance.

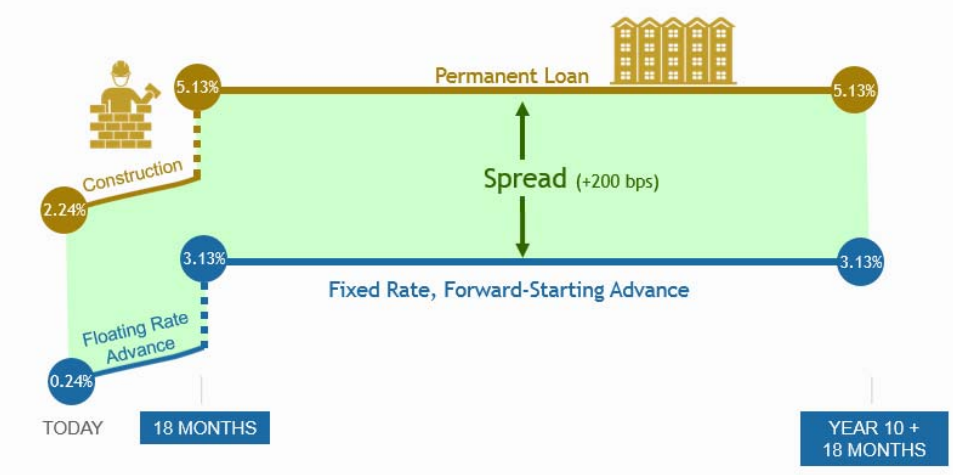
- Floating-Rate Advance: Floats at a spread to LIBOR or FHLB Discount Notes
- Fixed-Rate, Forward-Starting Advance: Scheduled to settle on the maturity date of the Floating-Rate Advance ensuring funding continuity

Benefits

- Be competitive in offering construction-to-permanent loans
- Lock-in a rate and protect your margin in a rising-rate environment
- Customize periods of floating and fixed rates
- Flexibility to choose the index of the Floating-Rate Advance

Hypothetical Example:

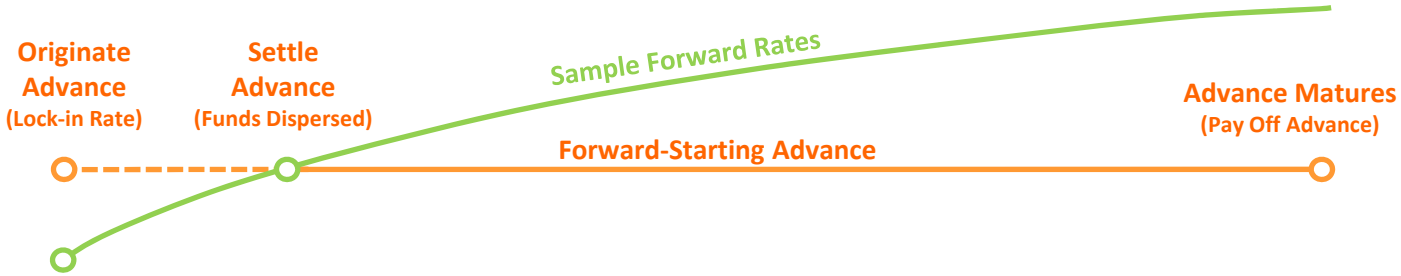
Match Fund Construction-to-Permanent Loan



Hypothetical rates/spreads assume a Floating-Rate Advance based on a 1-month LIBOR index and a Fixed-Rate, 20-year principal amortizing advance with a 10-year balloon, Forward-Starting in 18 months.

Provides flexibility to match your funding needs for construction-to-permanent loans. Lock-in your spread today with loan parameters that fit your needs.

Forward-Starting Advance Feature

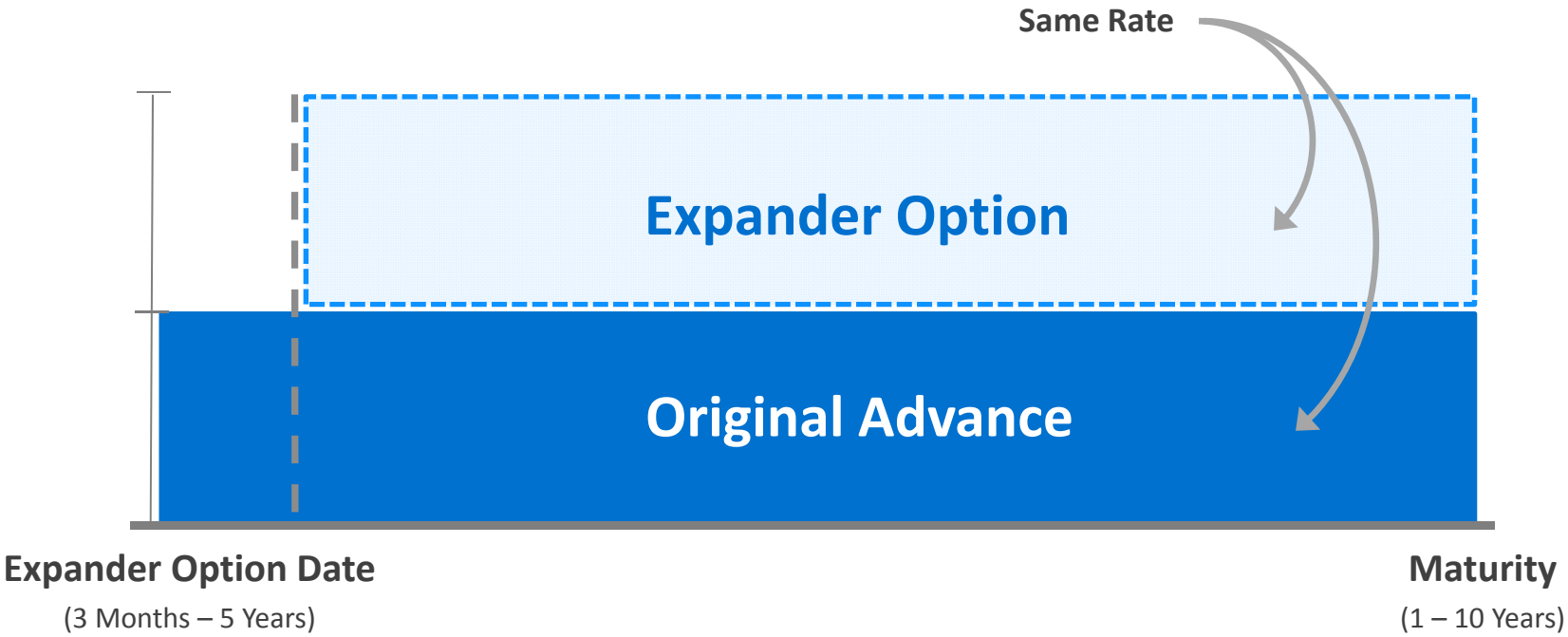


- Prepare for deposit outflows due to increasing rates
- Replace brokered CD funds with more competitively priced Bank funds
- Prepare for loan growth
- Match-fund and hedge against future rate increases
- Manage the impact of rising rate scenarios on net interest margin
- Unlock value in a historically low-rate, flat-yield curve environment
- Lock-in rates today to renew future maturing advances

Hedge for inflation risk - take advantage of the current low-interest rate environment by locking in a rate today for an advance that settles in the future.

Expander Advance

- Lock-in access to future funding at today's rate
- Replace higher cost funding or deposit run-off
- Fund future loan growth
- Support interest rate risk management strategies



Forward-Starting Advances: Lock-in Low Cost Funding Today

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Swap Forward Rates Spread

	Adv SC Rates	Fwd Cost 1Yr	2Yr	3Yr	4Yr	5Yr
1Yr	0.840	0.479	0.757	0.975	1.299	1.513
2Yr	1.094	0.378	0.626	0.897	1.166	1.369
3Yr	1.266	0.324	0.598	0.850	1.093	1.423
4Yr	1.406	0.324	0.584	0.820	1.148	1.315
5Yr	1.553	0.304	0.549	0.855	1.053	1.211
10Yr	2.152	0.327	0.327	0.723	0.922	1.105

Source: Bloomberg Forward Rates and FHLB Advance Rates in Secure Connect on fhlb.com

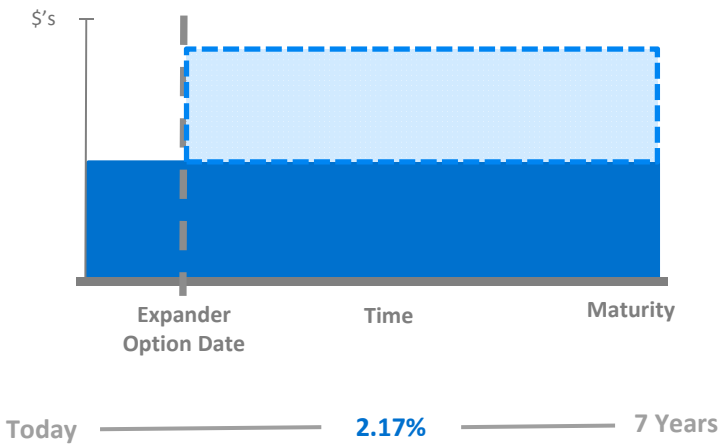
Sample pricing as of 09/06/2016

For example, the rate of a 4yr advance, 3yr forward would have been 2.226% (1.406% +0.820%)

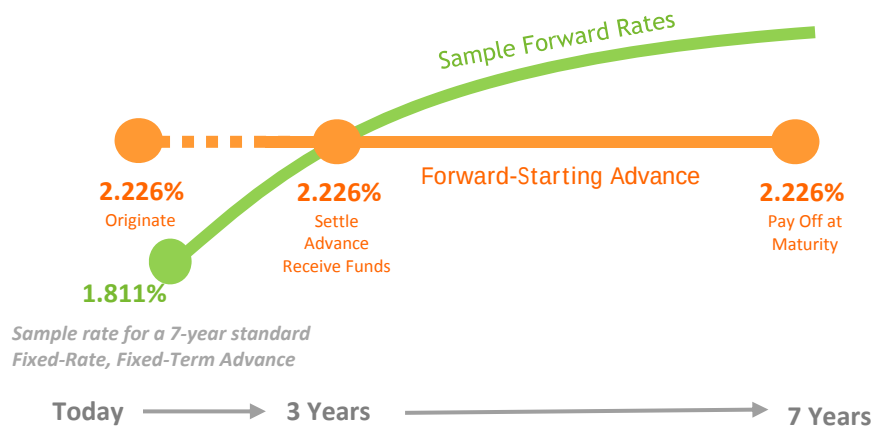
The Forward-Starting vs. Expander Advances

Hypothetical Example: 7-Year Advance, Forward-Starting in 3 Years

Expander Advance



Forward-Starting Advance



Lowest Cost

Secure Connect Advance Rates
3-Year Adv.: 1.266%
7-Year Adv.: 1.811%
10-Year Adv.: 2.152%

Increased Flexibility

Expander Advance rate indications
3-Year Advance with 1-Year Option: 1.42%
7-Year Advance with 3-Year Option: 2.17%
10-Year Advance with 5-Year Option: 2.59%

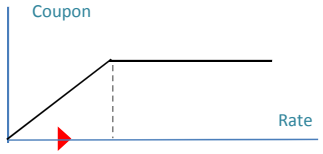
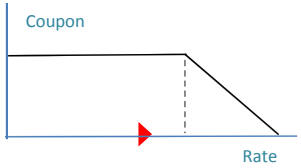
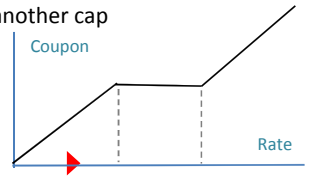
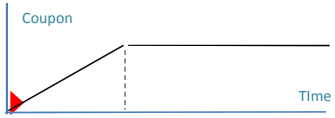
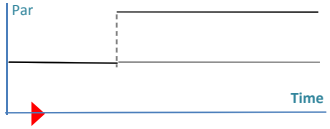
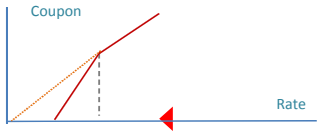
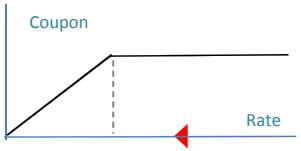
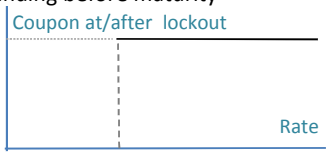
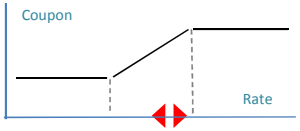
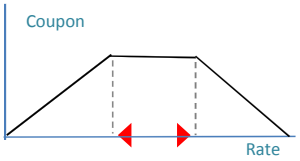
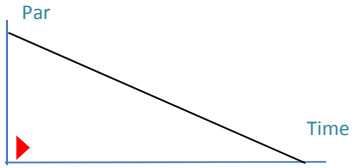
Forward Funding

Forward-Starting Advance rate indications
2-Year Advance, 1-Year Forward: 1.472%
4-Year Advance, 3-Year Forward: 2.226%
5-Year Advance, 5-Year Forward: 2.764%

Sample pricing as of 09/06/2016

FHLB Products

FHLBANK DALLAS

Rate VIEW	FLOATING RATE ADVANCES with Embedded Options	FIXED RATE ADVANCES with Embedded Options	NON-OPTIONED ADVANCES	OPTIONED ADVANCES
	Member is net long cap 	Member is net long cap 	Member locks in a fixed rate on the forward curve. There is no option.	
Rates Increase	Member is long cap plus short another cap 		Member is locking in rates on the forward curve. There is no option. 	Member owns option to increase borrowing at same coupon 
Rates Decrease	Member is net long floor 	Member is net long floor 		Member is long option to redeem funding before maturity 
Rates Change	Member is long cap plus short floor 	Member is long cap and floor 	No options Fixed Rate . 	Point in the rate cycle where it is ideal to borrow

FHLB Advances and their uses

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	Fixed-Rate	Floating-Rate	Short-term	Amortizing	Callable / Amortizer	NIM-Protection/ Expander	Forward-Starting	Letters of Credit	Floating-to-Fixed	Flattener-Steepener	MPF ®
Match-fund fixed rate loans	●			●	●			●			
Match-fund floating rate loans		●									
Match-fund loans with caps/floors						●					
Manage prepayment risk					●	●					
Optimize funding costs	●	●	●						●		
Manage interest rate risk / Deposit Run-off/ Basis Risk	●	●		●	●	●					
Fill short-term funding gaps			●								
Manage Liquidity needs								●		●	
Attract deposits								●			
Fund mortgage pipeline			●								
Sell Mortgage Loans											●

FHLBANK DALLAS

RateBeacon™

RateBeacon

RateBeacon™

FHLBANK DALLAS

- Member notification tool that is triggered when advance rates hit predefined thresholds specified by the member.
- Members can monitor rates for particular types and terms of advances

Benefits:

It allows members to:

- Take advantage of market rate movements
- Better manage their net interest margin
- Be notified of any advance specials, auctions etc.
- Select rate triggers on multiple advance types

It allows FHLB Dallas to:

- Understand our members needs, funding levels,
- Better serve our members

It takes less than one minute to set up RateBeacon.

RateBeacon™

FHLBANK DALLAS

❶ Set up 'RateBeacon'

'RateBeacon' page on fhlb.com

Enter Your Information

Name*
Name

Email*
Email

FHFA ID
FHFA ID (If Known)

Title
Title

Member Institution*
Member Institution

☐ I would like to receive email notifications for upcoming SecureConnect Advance Auctions and Special Advance Offers.

Short-Term

Term: SecureConnect Max O/N | Comparison: Less Than | Rate (%): 0.00 | Remove

+ Add More

Long-Term

Term: 1+yr thru 1.5yr | Comparison: Less Than | Rate (%): 0.00 | Remove

+ Add More

Please enter code in textbox at below

6 5 f 4 2

SUBMIT

Short-Term Options

SecureConnect Max O/N
SecureConnect Max Floater
SecureConnect Saver O/N
DNA 7 days
DNA 14 days
DNA 21 days
DNA 28 days
WLA O/N
WLA 2-7 days
WLA 8-14 days
WLA 15-21 days
WLA 22-35 days
1mo thru 2mo
2mo thru 3mo
3mo thru 4mo
4mo thru 5mo
5mo thru 6mo
6mo thru 7mo
7mo thru 8mo
8mo thru 9mo
9mo thru 10mo
10mo thru 11mo
11mo thru 1yr

Long-Term Options
(Bullet SC Rates)

1yr thru 1.5yr
1.5yr thru 2yr
2yr thru 2.5yr
2.5yr thru 3yr
3yr thru 4yr
4yr thru 5yr
5yr thru 6yr
6yr thru 7yr
7yr thru 8yr
8yr thru 9yr
9yr thru 10yr
10yr thru 11yr
11yr thru 12yr
12yr thru 13yr
13yr thru 14yr
14yr thru 15yr
19yr thru 20yr

❷ Receive confirmation email

❸ Receive 'RateBeacon' Notification

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C. Optimize Public Unit Deposits Management: Letters of Credit Benefits and Enhancements

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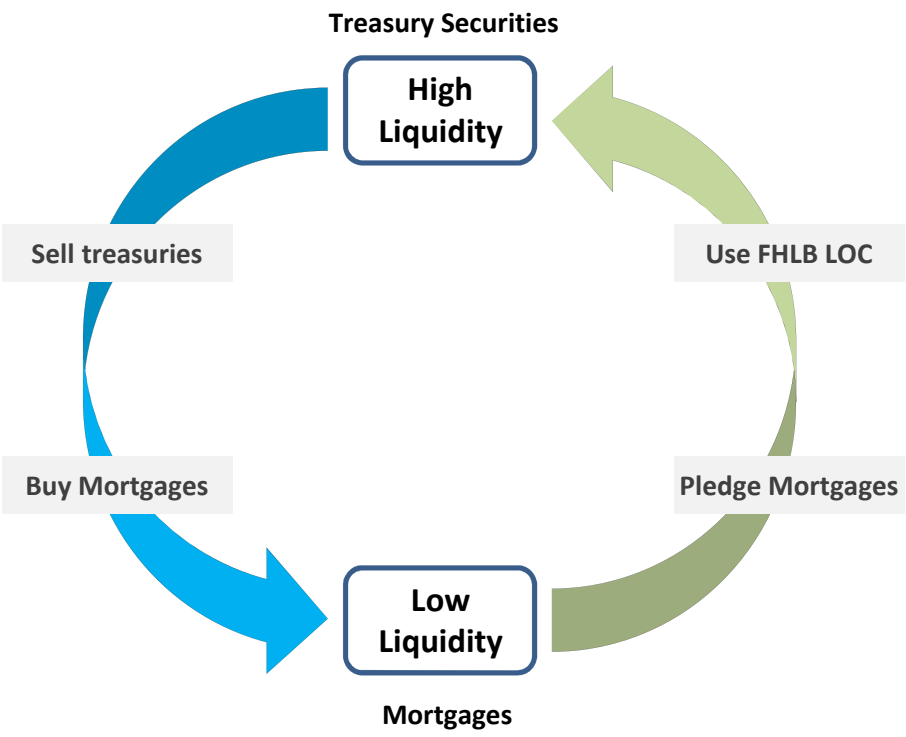
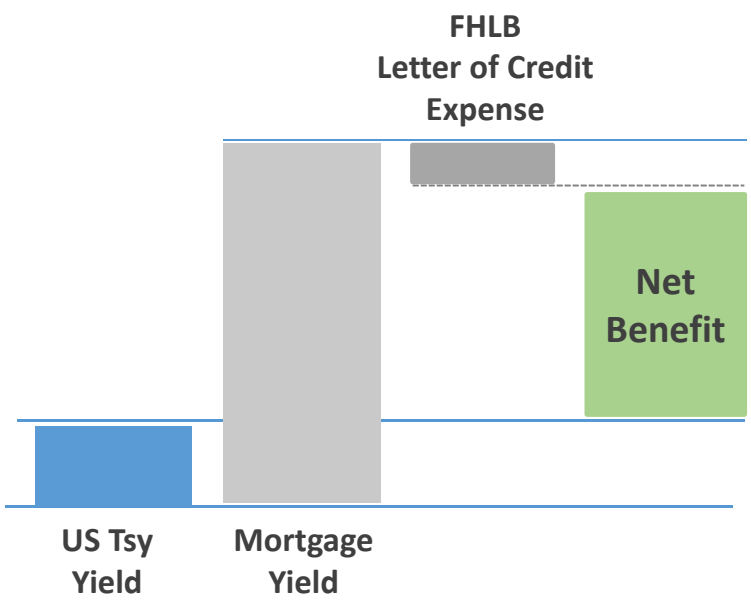
Optimize Asset Yield and Operational Efficiency

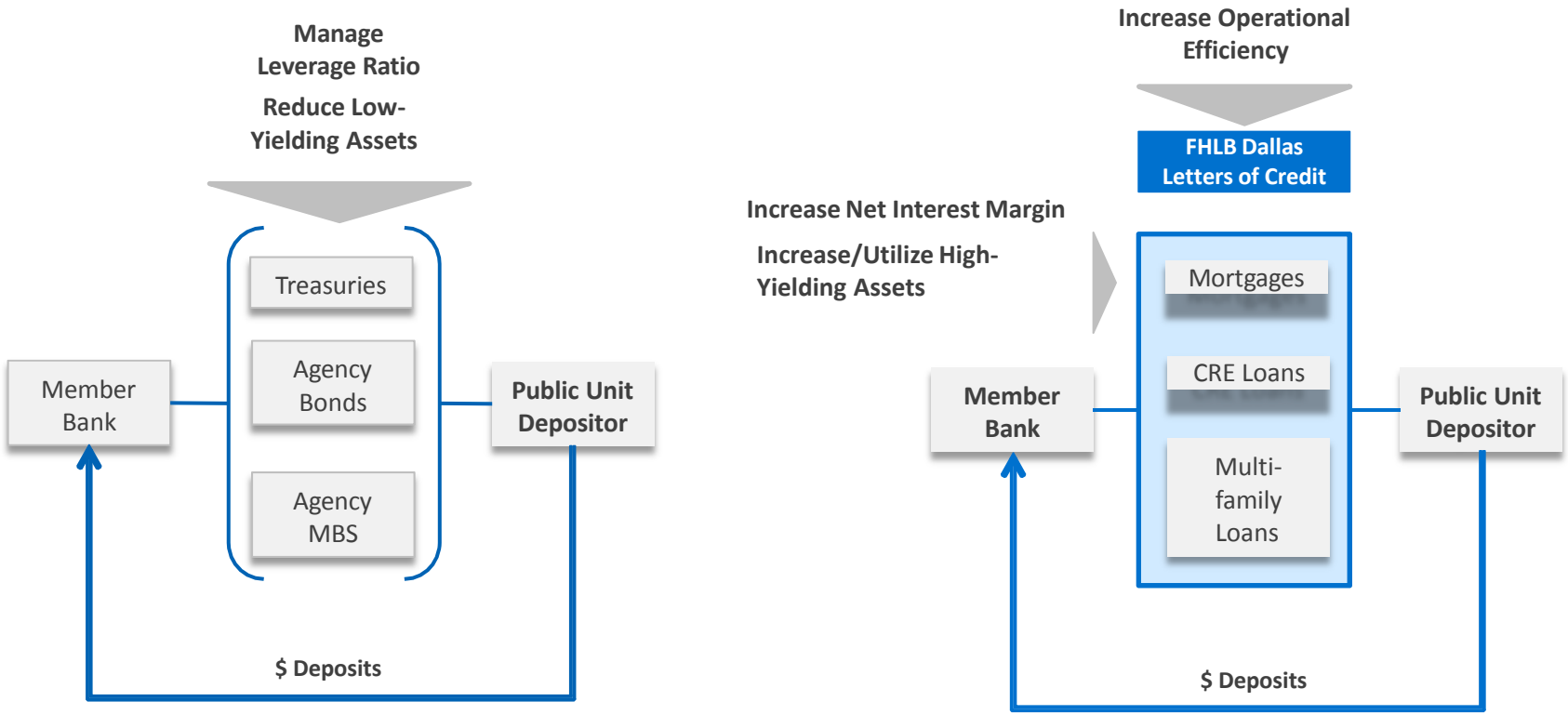




FHLB Dallas can help optimize your net interest margin by providing liquidity for less liquid assets through Letters of Credit.

FHLBANK DALLAS

Public Unit Deposit Letters of Credit



FHLB Dallas can help optimize your Net Interest Margin by providing liquidity for less liquid assets through Letters of Credit.

FHLBANK DALLAS

Pricing on All Letters of Credit

Low pricing of 5.5 basis points on all Standby and Custodial Letters of Credit.

Product	Up to 15 Years
SecureConnect Standby LOC / Custodial	5.5 bps
Non-SecureConnect Standby LOC / Custodial	5.5 bps
Community Investment Standby LOC	5.5 bps

Minimum Fee of $125 applies.

- The 5.5bps pricing does not apply to confirmations of LOCs

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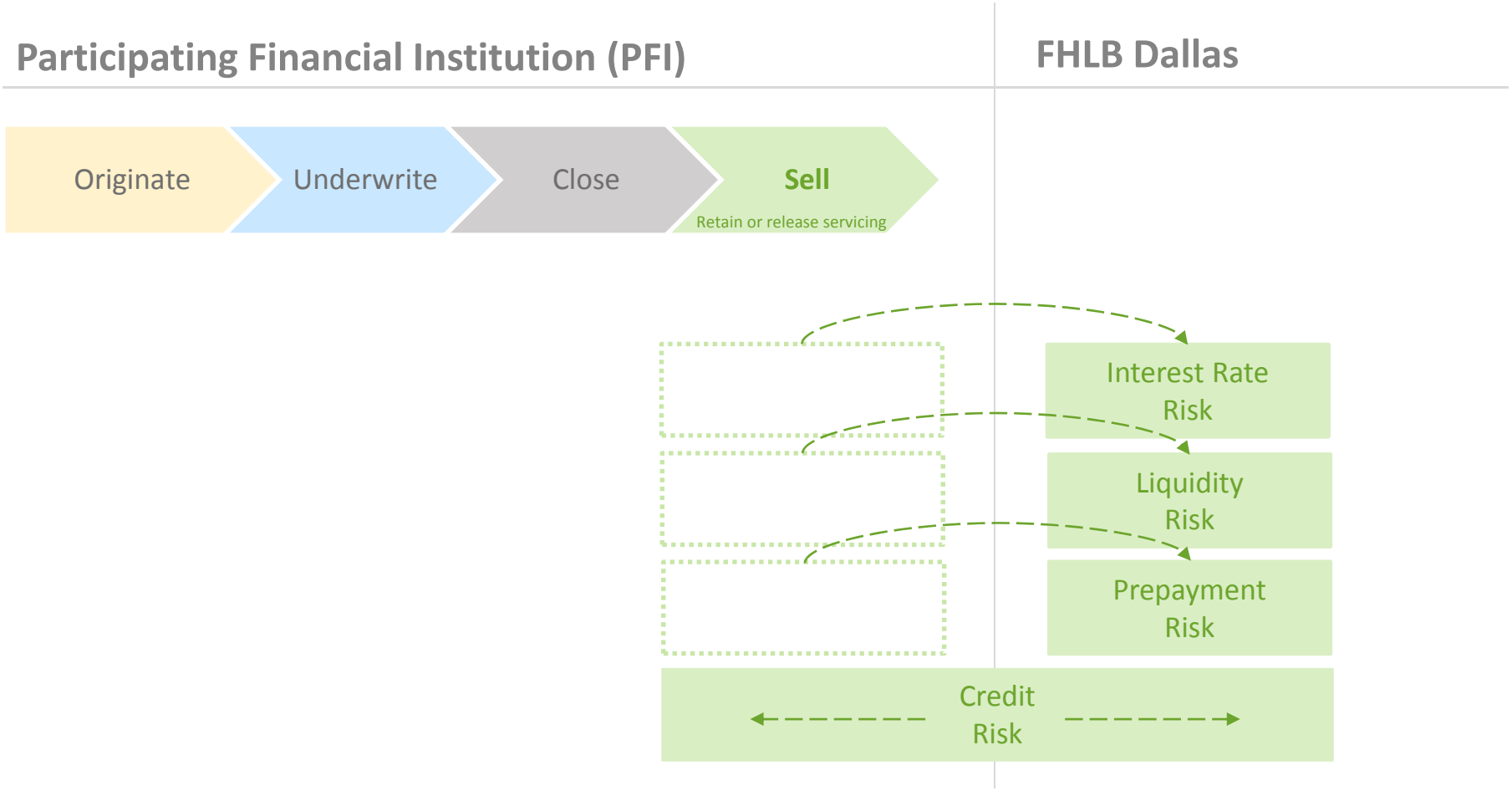
D. Mortgage Partnership Finance (MPF®) Program

FHLBANK DALLAS

MPF Program



The PFI receives a monthly "Credit Enhancement (CE) Fee" for sharing the credit risk of the loan through its "Credit Enhancement (CE) Obligation."

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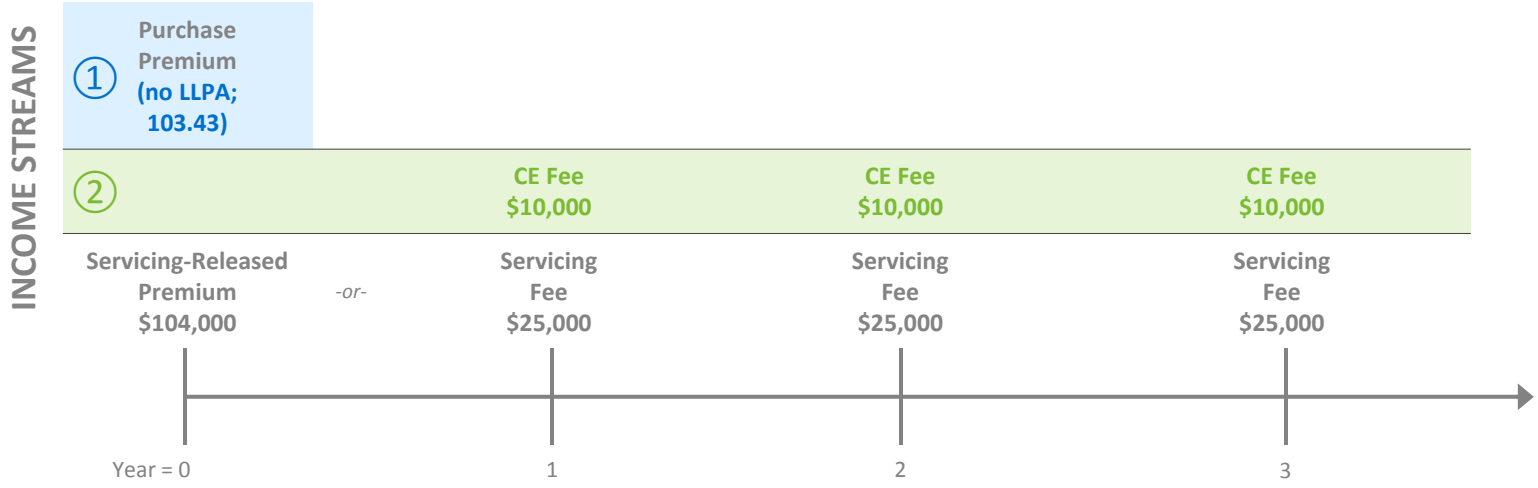
Key differentiators of MPF offer benefits for PFIs

Example: $10 million unpaid principal balance (UPB) of loans delivered into MPF Original

- Purchase Premium for 3.875% coupon with 10-day lock = **103.43 (no LLPA)**
  - Non-FHLB lender's LLPA = 1.25% for 719 FICO and 80% LTV
- **CE Fee = 10bps annually**
- One-time Servicing-Released Premium (SRP) for $250K loans in Texas = 104 bps *-or-* Servicing-Retained Fee = 25bps annually



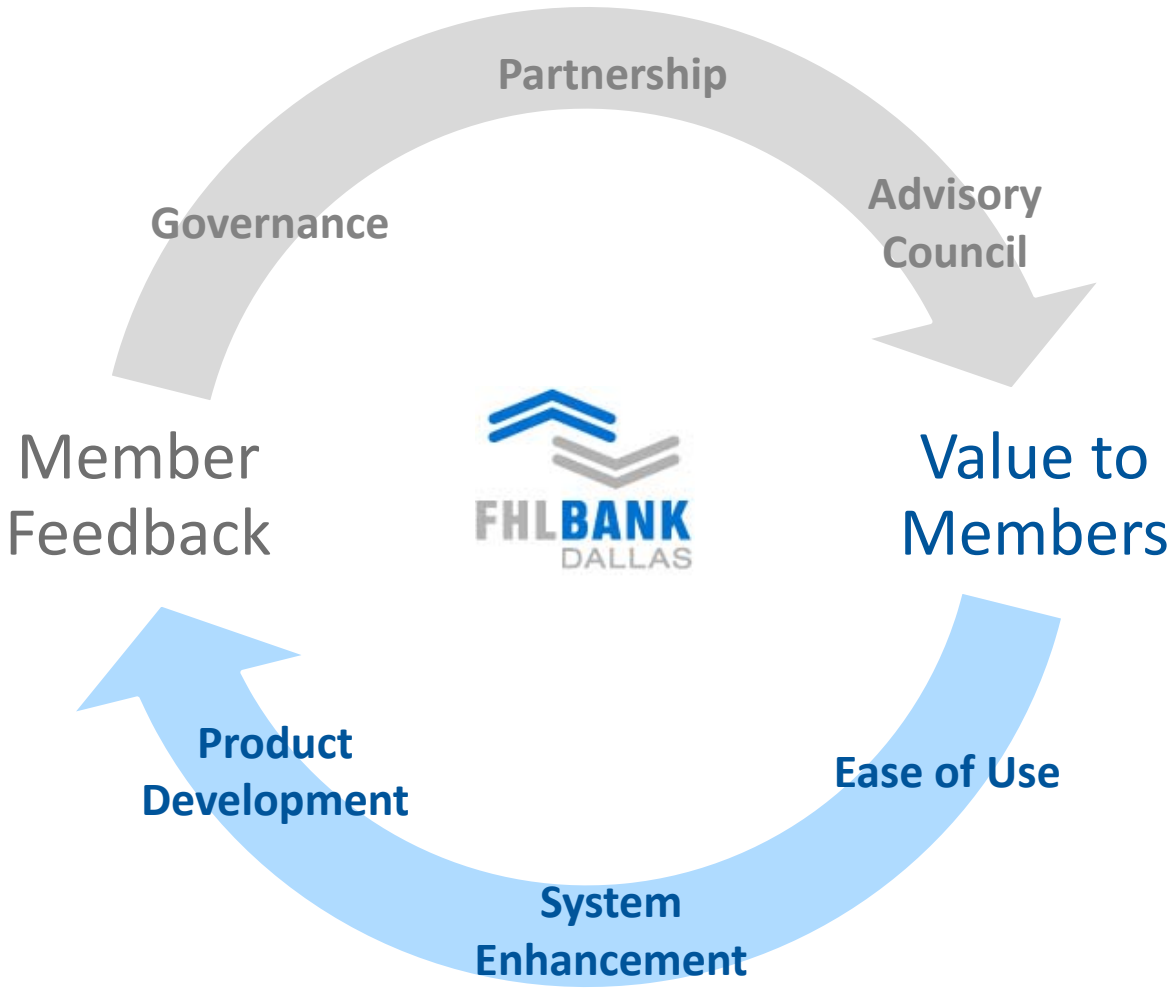
① Competitive purchase premium with **no Loan Level Pricing Adjustment (LLPA)**

② **CE Fee provides an ongoing income stream**
- PFI may retain or release servicing, and earns CE fee as loans perform in either structure

③ FHLBANK DALLAS is an accessible and responsive secondary market purchaser

Indication as of 08/18/2016.

A Valuable Partnership



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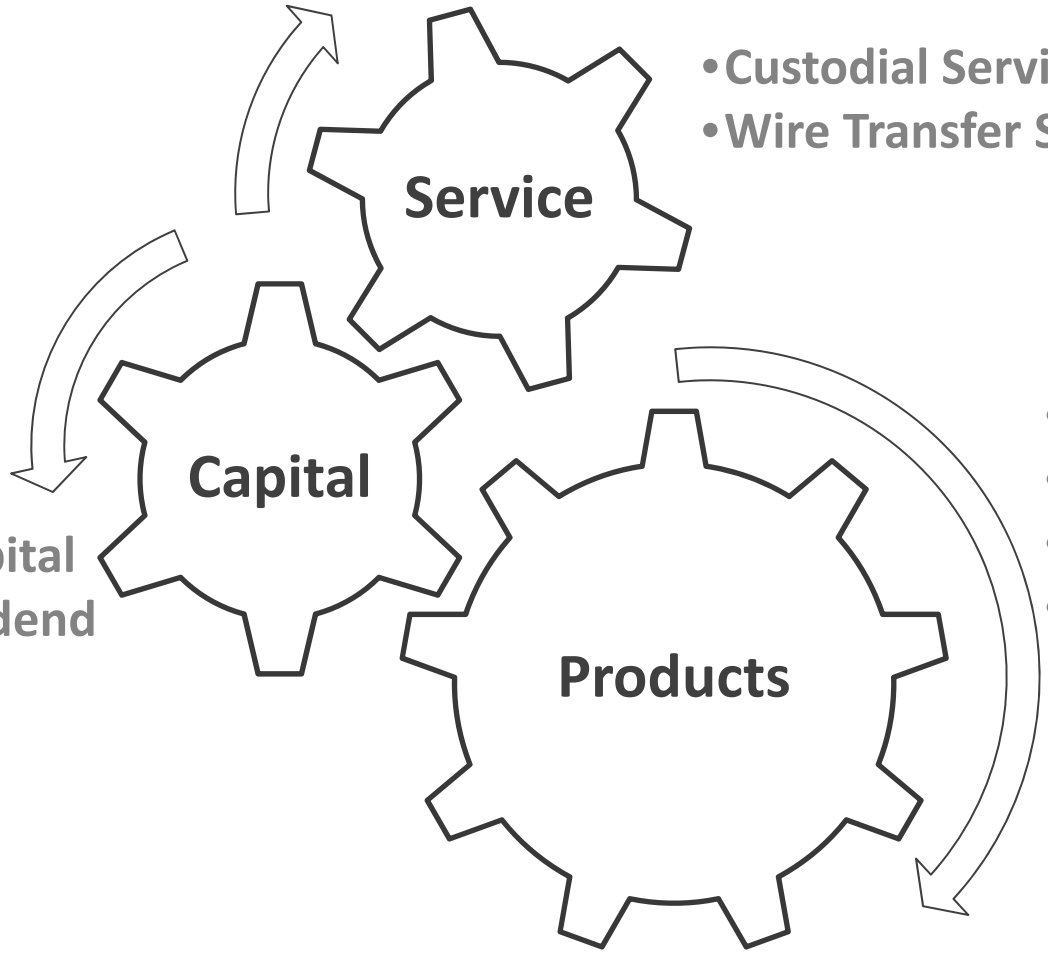
FHLB and Member: Innovation



- Custodial Services
- Wire Transfer Services

- Structured Advances
- Letters of Credit
- MPF
- Deposits

- Reduced Capital
- Activity Dividend

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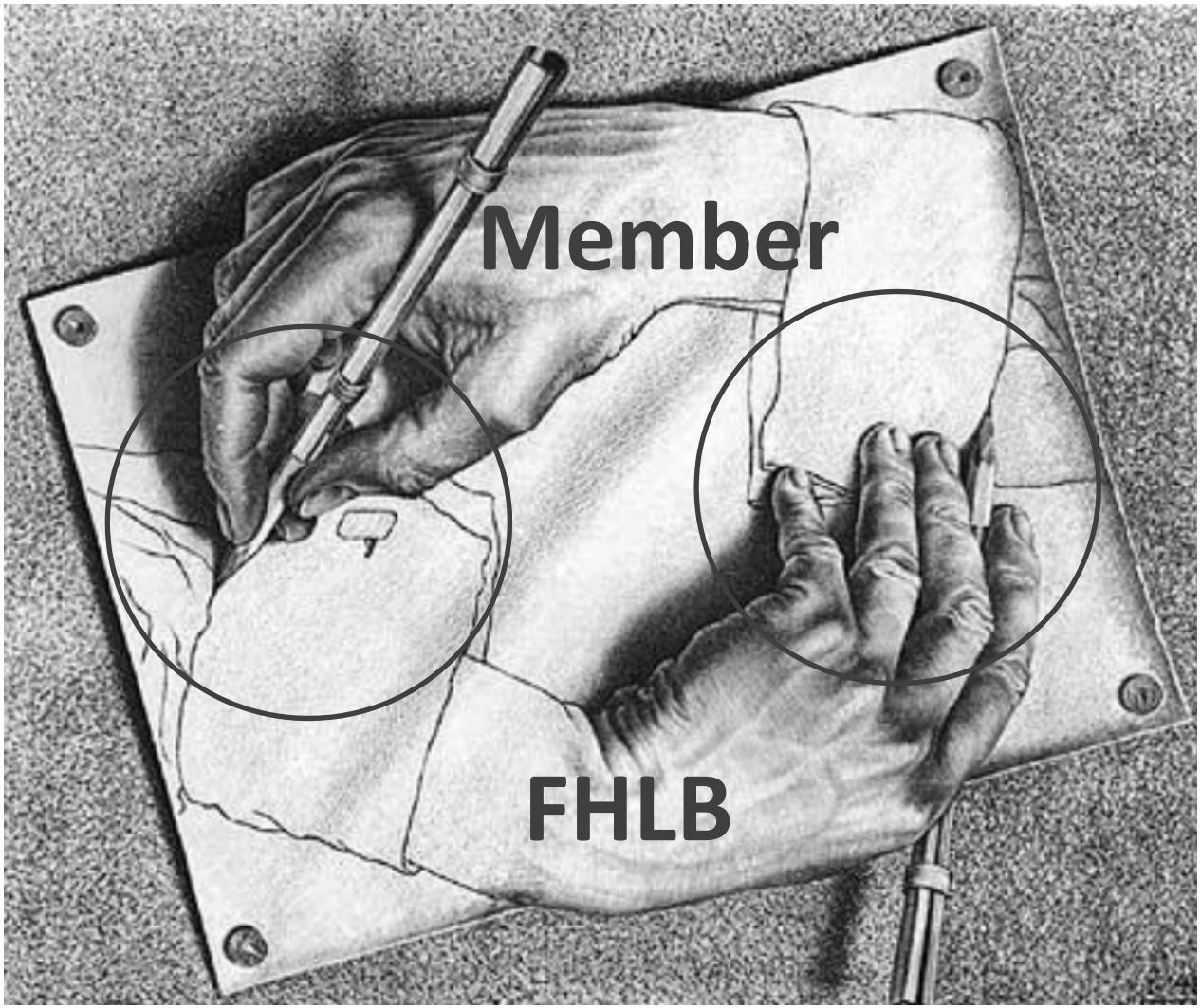
Value Proposition flows both ways



Lithograph By M C Escher

CYBERSECURITY AND NEW EXAM PROCEDURES

By: Susanna Blevins, CFE
Supervisory Examiner
Department of Savings and Mortgage Lending

Cybersecurity Defined

- The National Institute of Standards and Technology defines cybersecurity as "the process of protecting information by preventing, detecting, and responding to attacks."

Where does cyber risk fit in?

- With increasing reliance in technology, cyber risk is an integral part of operational risk
  - Can lead to compliance, reputation, and financial risk
  - Should be part of enterprise risk management process

Did you know?

- Wall Street Journal estimated that the cost of cyber crime in the US was approximately $100 billion in 2013 [1]
- Cyber crime costs quadrupled between 2013 to 2015 [1]
- Expected to quadruple again by 2019 [1]
- IBM Study: Average cost of data breach is $3.79 million [2]
- Actual losses may be higher!

1. Morgan, Steve. "Cyber Crime Costs Projected to Reach $2 Trillion by 2019", www.forbes.com . Jan 17, 2016
2. Kessem, Limor. "2016 Cybercrime Reloaded: Our Predictions for the Year Ahead, https://securityintelligence.com/2016-cybercrime-reloaded-our-predictions-for-the-year-ahead/. Jan 15, 2016

Who's at risk?

- Top three targeted industries
  - Public
  - Information
  - Financial Services

Cyber Threats, Trends, and Types

- Targeting smaller institutions
- Trojan Horses
- Malwares
- Distributed Denial of Service (DDoS)
- Ransomware

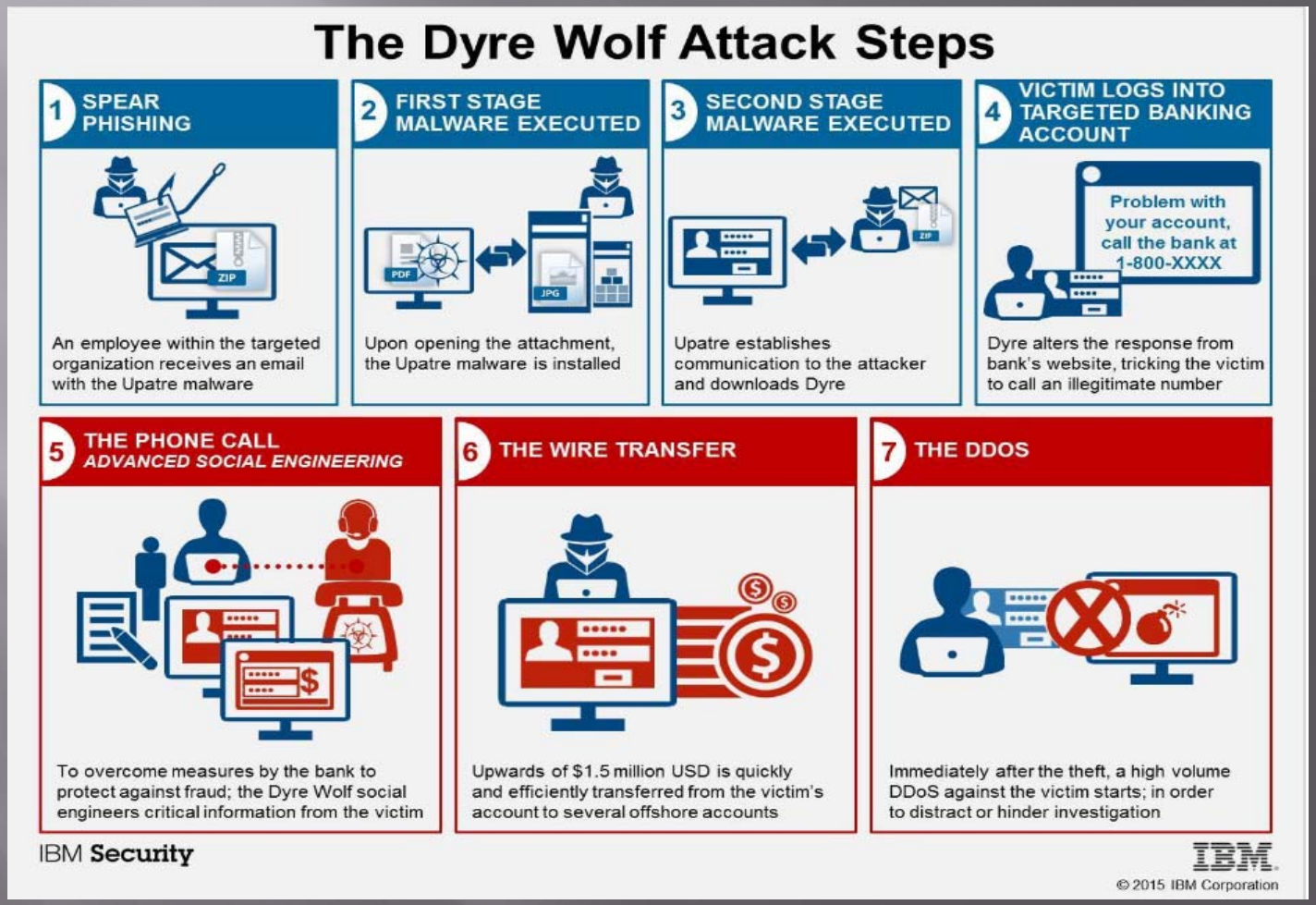
Carbanak

- Malware targeted banks' internal systems and operations
  - Affected more than 100 banks in over 11 countries
- Used spear phishing emails to steal credentials
- Stealth attackers were able to study and exploit control weaknesses
- Affected core operating systems
  - Created fraudulent accounts; changed balances
  - Wired funds
  - Also affected ATMs and online banking
- Losses tripled in one day from $300MM to $1B

Source: Kessem, Limor. "**Carbanak: How Would You Have Stopped a $1 Billion APT Attack?**" **https://securityintelligence.com/carbanak-how-would-you-have-stopped-a-1-billion-apt-attack/**. **Feb 23, 2015**

Dyre Wolf

Targeted organizations have lost between $500,000 to $1.5 million to attackers in recent attacks



Source: Kuhn, John. "The Dyre Wolf Campaign: Stealing Millions and Hungry for More" https://securityintelligence.com/dyre-wolf/ Apr 2, 2015

What can be done to mitigate risk?

- People – Training and expertise
- Process – Internal Control Best Practices
- Technology – Access management, patch management, system testing

- Question: Does your institution's insurance cover cyber crimes? Additional requirements?

Regulatory Response

- Established Cybersecurity & Critical Infrastructure Working Group (CCIWG)
- Partnering with law enforcement, other financial regulators, Treasury Department, DHS, and intelligence community
- Joint statements and alerts
- Cybersecurity Assessment Tool

Enhanced Monitoring of IT

- New InTREx work program launched July 1, 2016.
- Currently a one size fits all approach
- Four components
  - Audit
  - Management
  - Development and Acquisition
  - Support and Delivery
- FIL 43-2016 Information Technology Risk Examination (InTREx) Program

Examination Tools Suite (ETS)

- New exam documentation program designed to safeguard private information
- Nationwide rollout scheduled to be complete by end of September 2016
- Be patient with us

Resources

- FFIEC Guidance Resource Center
  - http://ffiec.bankinfosecurity.com/
- Cybersecurity awareness website
  - http://www.ffiec.gov/cybersecurity.htm

SHARED SERVICES

2016 Thrift Industry Day

By: Andrea Henderson

WHAT ARE SHARED SERVICES?

- Shared resource arrangements in which institutions pool human, technological, or compliance resources in order to reduce costs, increase operational efficiencies, and leverage specialized expertise.
- Represents a more collaborative effort among institutions as opposed to handing off responsibilities to a third party.

BENEFITS OF SHARED SERVICES

- To improve efficiency
- Save on costs
- Gain economies of scale
- Maintain regulatory compliance
- Expand customer access to products and services

SOME SHARED RESOURCE OPPORTUNITIES

- Credit review
- Auditing
- IT Services
- Regulatory Compliance
- Shared resource arrangements present opportunities to lower these non-income producing activities.

EXAMPLE OF A SHARED SERVICE ARRANGEMENT

- In one known case, a group of four community banks partnered together to share ownership of a data processing provider. In addition to cutting costs, the arrangement was structured in a unique way to avoid the operational risks that arise when a single bank maintains its own processing system onsite. The service-provider was housed in the basement of one bank, yet a backup site was established at a second bank. The service provider also served banks outside of the arrangement on a fee basis and generated income for the four partner banks.

RISK CONSIDERATIONS AND MITIGATION

- Operational Risks- uncertainty over which institution has control over a shared employee or property in times of need may result in a conflict.
- Reputational Risks- to avoid public confusion and to protect customers, the OCC instructs banks sharing resources to disclose that they are separate entities, as opposed to partnerships or joint ventures.
- Legal Risks- employment law issues

REGULATIONS

- The OCC requires that each institution involved in a shared resource arrangement segregate their assets and records, and conduct business with each other at an arm's length when sharing either employees or space.
- Banks utilizing shared resource arrangements should ensure their activities comply with federal laws against anticompetitive practices.

CONCLUSION

- Shared resource arrangements should be approached like other business decisions with due diligence and a thorough consideration of the risks and benefits.
- This may not be appropriate for all activities or institutions; however, sharing resources may be a means to gain efficiencies, improve compliance, or expand customers' access to services.
- With proper controls and ongoing oversight, shared resources may be a viable component to a community bank's overall strategic objectives.

Compliance Update

Bill Poe
Supervisory Compliance Examiner

Overview

- FDIC Compliance Exams Ratings Results
- FFIEC Proposal to Revise Compliance Rating System
- Ongoing Regulatory Changes

FDIC Compliance Examinations-Nationwide

- 98 percent of FDIC-supervised banks are rated “1” or “2” in Compliance
- For Community Reinvestment Act(CRA) evaluations, 99 percent of FDIC-supervised banks are rated either “Outstanding” or “Satisfactory”
- Compliance Ratings generally improving with 22 percent of banks receiving an upgrade compared to only 8 percent receiving a downgrade

FDIC Compliance Examinations- Texas SSBs

- 100 Percent of Texas State Savings Banks are rated "1" or "2" in Compliance
- 23 Percent "1" rated
- 77 Percent "2" rated
- For Community Reinvestment Act(CRA) evaluations, 100 percent of Texas SSBs are rated either "Outstanding" or "Satisfactory"

Consumer Compliance Rating System

Proposed Revisions to Consumer Compliance Rating System

- The current interagency compliance rating system was adopted in 1980
- On April 29, 2016, FFIEC issued a proposal to modernize the rating system to better reflect supervisory approaches already being used agencies
- The revisions are intended to better align the rating system with risk-based, tailored examinations
- Revisions do not increase supervisory expectations

New Framework

- Maintain numeric scale of 1 through 5 in order of increasing supervisory concern
- An institution would be assigned an overall compliance rating based on the effectiveness of its CMS using three categories of assessment factors
  - Board and Management Oversight
  - Compliance Program
  - Violations of Law and Consumer Harm

Ongoing Regulatory Changes

- Proposed TRID Rule Amendment
- Final Amendments to Mortgage Servicing Rules
- HMDA Updates

Proposed Amendment to TRID

- On July 28, 2016, CFPB issued a 293 page proposal to amend the TRID rules
- Comment period open until October 18th

The proposal is not a complete revamp of the TRID rules, but rather, provides clarifications and guidance on a number of topics, relying heavily on previous informal guidance and the CFPB webinars.

What's in the proposal?

- Provides additional guidance on sharing disclosures with sellers, real estate agents, and other involved parties
- Creates tolerances for total of payment
- Calculating Cash to Close Table

- Clarifications on Construction Loans
- Lender and Seller Credits
- Good faith disclosure of property taxes and property value
- Rate Locks
- Recording fees
- Total Interest Percentage (TIP) Calculations

Amendments to Mortgage Servicing Rules

- On August 4, 2016, CFPB issued a 901 page final amendment to mortgage servicing provisions of Regulation X and Regulation Z
- Expands Small Servicer Exemption (5,000 loans or fewer) so certain seller-financed transactions and voluntarily serviced loans are not counted in the loan limit
- Generally, the amendments take effect 12 months from date of publication in the Federal Register (has not occurred)

- Force-placed insurance notices and model forms
- Early intervention and loss mitigation
- Periodic statements to borrowers in bankruptcy (18)
- Protections for successors in interest of properties

HMDA Updates

- In July 2016, FFIEC published a 48 page Filing Instructions Guide for HMDA Data Collected in 2017
- A separate 79 page Filing Instructions Guide was issued for Data Collected in 2018

HMDA For Data Collected in 2017

- Applies to data collected in calendar year 2017
- Information will be submitted in 2018
- Responsibility for receiving data is transferred from the FRB to CFPB
- Requires a specific Loan Application Register (LAR) electronic file format
- Reported data fields on the LAR have not changed (2018)
- Information will be submitted using web-based interface referred to as the HMDA Platform

Questions?

Current Expected Credit Loss Model (CECL)

Stephany Trotti, CPA

Chief Thrift Examiner

Summary

- **What is CECL?**
- **Why was CECL necessary?**
- **When do I have to worry about?**
- **What does it apply to?**
- **What is the objective?**
- **Key Points**
- **Samples**
- **What to do to be prepared?**
- **What is the supervisory response?**
- **Resources**

What is CECL?
Current Expected Credit Loss
ASU 2016-13

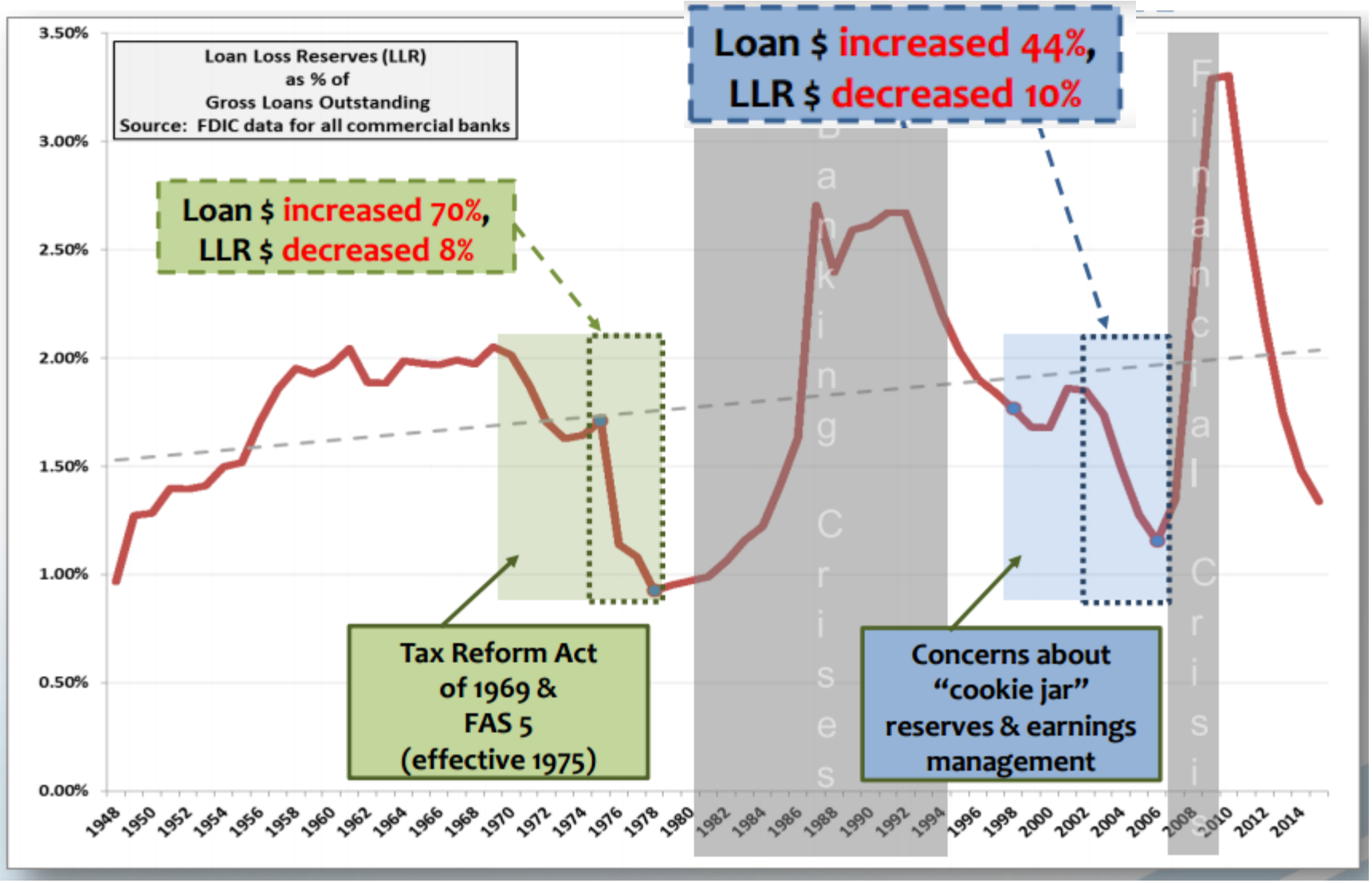
- **FIL-39-2016 Joint State on the new accounting standard on Financial Instruments – Credit Losses (issued June 17, 2016)**
- **New ALLL methodology**
- **Shift in focus from incurred loss to lifetime expected loss estimate**
- **Requires management to estimate all contractual cash flows that it does not expect to collect over the lives of loans and other debt instruments measured at amortized cost**

Why was CECL necessary?

Weaknesses in Current Accounting

- ***Delayed recognition of losses***
- ***Inability to consider forward-looking information***
- ***Multiple impairment models***

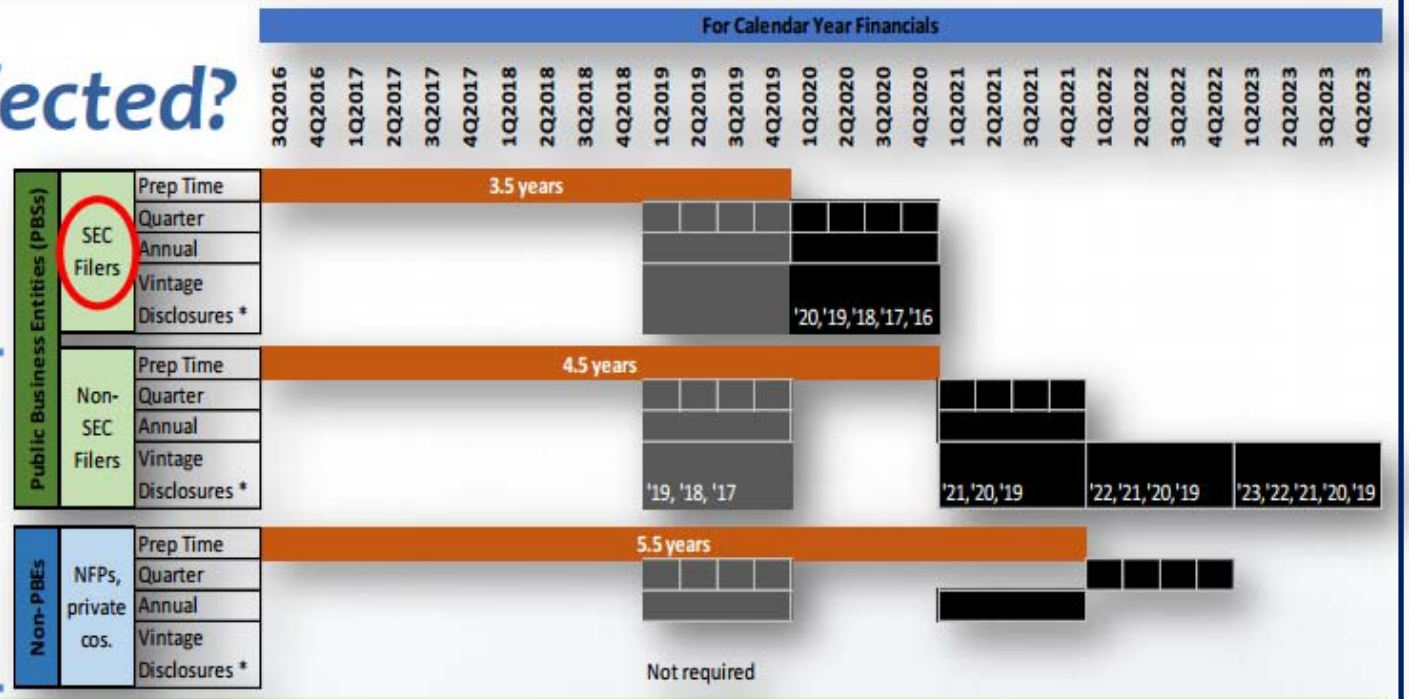
Why was CECL necessary?



When do I have to worry about it?

- The FASB provided a long transition timeline:
  - Public business entities (PBE) that are U.S. Securities and Exchange Commission (SEC) filers5 (SEC filers): Fiscal years beginning after December 15, 2019, including interim periods within those fiscal years.
  - Other PBEs (non-SEC filers6): Fiscal years beginning after December 15, 2020, including interim periods within those fiscal years.
  - Non-PBEs (private companies): Fiscal years beginning after December 15, 2020, including interim periods beginning after December 15, 2021.
- ***Early adoption not allowed.***

CECL . . .
Who's Affected? When?



May require more analysis

Time available for implemention
Earliest date adoption permitted
First period adoption required
* For interim-periods, current year-to-date considered to be current-period originations.

"SEC filer" is any entity required to file or furnish its financial statements with either:

- The Securities and Exchange Commission
- An entity subject to Section 12(i) of the Securities Exchange Act of 1934, as amended, the appropriate agency under that Section.

What does it apply to?

Loans		Debt Securities	
Held for Investment	CECL PCD	**Held to Maturity**	CECL PCD
Held for Sale	Lower of amortized cost basis or market	**Available for Sale**	AFS credit-loss* PCD
		Trading	FV-NI **

*Under the new credit-loss method for AFS, credit losses will be recorded through an allowance. The allowance will be limited to the difference between the debt security's amortized cost basis and its fair value.

** No change to current GAAP.

What is the objective?

Each reporting date, the allowance will reduce the net carrying value to the amount an entity expects to collect

- Reflects management expectations based on past events, current conditions, and reasonable and supportable forecasts
- Reflects the use of forward looking information
- Incorporates expected losses over remaining contractual life at the reporting date

Amortized cost . . .
unpaid principal balance (UPB) lent to a customer adjusted for loan fees and origination expenses, repayments, writeoffs, nonaccrual practices, and certain hedging transactions

Book the difference as Allowance

$$A - B = C$$

Amount expected to be collected. . .
remaining amounts expected to be collected

Key Points

- Expected credit losses shall be measured on . . .
  - Collective (pool) basis if…
    - Similar risk characteristic(s) exist, which may include (not all inclusive): Credit rating, asset or collateral type, size, interest rate, term, geographic location, borrower industry, or loan vintage
  - An individual basis if…
    - Asset does not share similar risk characteristics with other financial assets
    - Example: a loan in default or a receivable past a delinquency period

….**But not included in both!**

Key Points

- Expected credit losses shall be measured over . .
  - Contractual term, considering estimated prepayments
  - Contractual term shall not be extended for
    - Expected extensions and renewals
    - Expected modifications, unless TDR anticipated
- Expected credit losses may be determined using
  - Various Methods
  - ***Not*** *required to ….*
    - *Utilize DCF model*
    - *Reconcile estimation technique with DCF model*

Key Points

- Shall develop reasonable and supportable forecasts . . .
  - Shall not solely rely on past events to estimate expected credit losses
  - Adjust historical information to reflect current events and reasonable and supportable forecasts
  - Adjustments may be qualitative in nature and reflect changes to relevant data
- Shall consider available information relevant to assessing collectability…
  - Information includes internal, external or both

Key Points

- For periods where forecasts are not supportable. . .
  - Entity shall revert to historical credit loss information…
    - Reflective of the contractual term
    - "immediately on a strait-line basis, or using another rational and systematic basis"
    - Shall not adjust for existing and expected future economic conditions
  - Not expected to use reversion technique
    - If entity is able to forecast over the estimated life
  - Reasoning:
    - Reversion is needed to meet measurement objective:
      - Amount an entity expects to collect
    - Not decision useful to ignore certain time periods
      - Merely because an entity is unable to precisely estimate

Samples

Now lets look at 3 different approaches...

- Percentage Loss Rates
- Dollar Loss Rates
- Vintage Analysis

Fact Pattern:

Year end 20X5

Amort. Cost Basis = $10M

Management expects in 20X6 and 20X7:

- Fall in real estate values
- Rise in unemployment
- Improved underwriting

Management cannot reasonably forecast beyond 20X7

Percentage Loss Rates

Historical loss rate (cumulative)	1.50%
Adjustment for current conditions and reasonable and supportable forecasts	0.15%
Expected loss rate	1.65%
Loan loss reserves	$165K

Dollar Loss Rates

Historical loan losses (cumulative)	$150k
Fall in real estate values	+15K
Rising unemployment	+ 5K
More experienced underwriting	- $1K
Loan loss reserves	$169K

Vintage Analysis

Year Originated	Year 1	Year 2	Year 3	Year 4	Year 5	Expected Losses
20X0	$1	$20	$14	$8	$2	n/a
20X1	1	22	16	8	4	$ 4
20X2	2	23	18	10	4	14
20X3	2	24	22	12	2	36
20X4	2	26	21	8	2	57
20X5	6	24	16	8	2	56
					Total	$ 167

Shading represents realization timing of expected losses:

- 20X6
- 20X7
- 20X8 and thereafter

Reasonable & Supportable forecasts

Reversion to historical loss information

Which one do the regulators want to see?

There is not a right or wrong answer. The methodology should be well documented and reasonable given the credit practices of each bank.

What can you do to be prepared?

- Don’t wait to prepare
  - Educate yourself on the implications of CECL
  - Ensure loan system is collecting needed data
- No artificial inflation of ALLL to smooth impact
  - No “cookie jar” reserves
  - Day 1 adoption through retained earnings, not P&L
- Does not stop you from setting aside capital for potential additional future reserves

What is the supervisory response?

- **Establishing best practices for examiners to follow**
- **Conducting outreaches with the industry**
- **Inventory existing supervisory guidance**
  - **New Interagency policy statements to be issued**
- **Develop additional guidance and tools**

Resources:

Webinar: IN FOCUS: FASB Accounting Standards Update on Credit Losses (July 21, 2016)

- http://www.fasb.org/jsp/FASB/Page/SectionPage&cid=1175801858807

Ask the FED

- https://bsr.stlouisfed.org/askthefed

American Bankers Association

- http://www.aba.com/Issues/Index/Pages/Issues_LoanLoss.aspx

FASB: ASU 2016-13 Financial Instruments-Credit Losses (Topic 326)

- http://www.fasb.org/jsp/FASB/FASBContent_C/CompletedProjectPage&cid=1176168232014

Any questions/comments?

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