

Breakout 4:  
**Is Your Regulatory  
Relationship OK?**

**Bart Smith**

*Performance Trust Capital Partners, LLC*



**BankDirector.**

#BBTF24

JUNE 5-7, 2024

# Is your Regulatory Relationship, OK?

**Bart Smith**

**Managing Director & Partner**

**Performance Trust Capital Partners**

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Do you have a good relationship  
with your regulator?

# Requests for Reviews of Material Supervisory Determinations

Out of 37 requests over seven years, 3.5 were overturned

Date	Request	Result
4/5/2024	Compliance rating	Denied
2/20/2024	Federal Trade Commission Act Violation of UDAP	Denied
2/15/2024	Asset Quality rating	Denied
1/16/2024	Apparent violation of the Fair Housing Act (FHA)	Violation Overturned
1/3/2024	CAMELS Ratings	Changed AQ rating, no other changes
12/19/2023	Community Reinvestment Act (CRA) rating.	Stay
11/13/2023	Community Reinvestment Act (CRA) rating.	Denied
10/2/2023	Re-classification of Held-to-Maturity securities	Denied
9/28/2023	Management rating	Denied
9/8/2023	Management rating and violations of the Bank Secrecy Act.	Denied
5/26/2023	Violation of Federal Reserve Board Regulation O.	Denied
12/29/2022	Community Reinvestment Act (CRA) rating.	Stay
11/23/2022	CAMELS Ratings & Consent Order	Changed Certain ratings, left Order
11/14/2022	Apparent violations of Section 23A of the Federal Reserve Act.	Violation Overturned
9/8/2022	Determination on brokered deposits.	Denied
7/18/2022	Apparent violation of Section 23B of the Federal Reserve Act.	Denied
10/22/2021	Loss classification associated with an overdraft.	Denied
7/8/2021	Sensitivity to Market Risk Component Rating.	Denied
6/11/2021	Apparent violation of Federal Reserve Board Regulation O.	Denied
10/27/2020	Management Rating.	Denied
6/23/2020	Management Rating and Dominant Official.	Denied
5/21/2020	CAMELS Ratings & MOU	Denied
11/6/2019	Accounting for Sale of Other Real Estate	Denied
9/30/2019	CAMELS Ratings	Denied
9/17/2019	Federal Trade Commission Act Violation of UDAP	Denied
6/17/2019	Community Reinvestment Act (CRA) rating and UDAP	Denied
4/19/2019	Community Reinvestment Act (CRA) rating.	Denied
12/20/2018	Accounting and risk-weighting for multi-family loan participations	Denied
12/11/2018	CAMELS Ratings	Denied
8/10/2018	Liquidity rating.	Denied
8/2/2018	CAMELS Ratings	Denied
7/31/2018	Capital and Liquidity ratings.	Ratings Upgraded
7/10/2018	Determination that prepaid debit cards are brokered deposits.	Denied
7/10/2018	Management rating and apparent violations of Part 326 and Part 353	Denied
6/4/2018	Rating and prepaid debit cards are brokered deposits.	Split Decision
2/26/2018	Classification of two c Shared National Credit (SNC)	Denied

How do you create a good  
regulatory relationship?

## What Risks are Regulators Focused on Today

# Tougher regulation on large banks will 'trickle down' to community banks

Tuesday, May 30, 2023; By Lauren Seay; *Market Intelligence*

### Non-regulators

- “While that impending rulemaking will only impact [large] banks, community banks can expect increased regulatory scrutiny on those topics too during their exams”
- “The regulatory world and others are going to come down harder on the rest of the 98% of the banks that don't look like the banks that failed”

### Regulators

- “Banks need to be aware of the complexity of what's going on externally and how does that impact your bank and **how are you prepared to withstand whatever storm may come.** The risks are more complex because they are intertwined and one could trigger the other.”
- “We will be looking at your risk assessments internally, your reserves, your capital position and so forth. **How tough an exam is will be determined by each individual bank's operating model. It depends on your risk profile, your risk appetite and the fundamentals of your CAMELS.**”
- “given how the external factors are changing, remediation may need to be quicker than we had during peacetime economy when things were stable.”

## What Risks are Regulators Focused on Today

# OCC examiners will use 'discretion' as they zero in on banks' risk management

Wednesday, June 14, 2023; By Allison Bennett; *Market Intelligence*

- The Office of the Comptroller of the Currency laid out what specific steps banks should be taking as it [ups its scrutiny](#) of risk management practices and encourages supervisors to exercise discretion in exams.
- Following the recent industry tumult after three bank failures, the OCC's supervisory focus will be "risk management, risk management, risk management," acting Comptroller Michael Hsu told reporters June 14. He reiterated that sentiment later in the day when the agency released its [Semi-Annual Risk Perspective](#), saying the OCC "expects banks to be on the balls of their feet with regards to risk management, just as our examiners are."

## What is Risk Management Formula?

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**What is the formula for good risk management?**

**Identify**

**Measure**

**Monitor**

**Control**



# What is Risk Management Formula?

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## Supervisory Guidance with Identify, Measure, Monitor & Control

**Capital**...risk may not always be reflected in the current financial condition. Therefore, examiners should not rely solely on an institution's current financial condition when determining capital adequacy and must assess management's ability to **identify, measure, monitor, and control** all material risks that may affect capital.

**Real Estate Lending**...real estate lending policies generally enable management to effectively **identify, measure, monitor, and control** the risks associated with real estate lending.

**Investments**...the policy statement declares that banks should implement programs to manage the market, credit, liquidity, legal, operational, and other risks that result from investment activities. Adequate risk management programs **identify, measure, monitor, and control** these risks.

**Management**...To ensure safe and sound operations, it is important that, like any other risk, a bank's board and management **identify, measure, monitor, and control** model risk. .

**Liquidity**...rating is based upon the capability of management to properly **identify, measure, monitor, and control** the institution's liquidity position, including the effectiveness of funds management strategies, liquidity policies, management information systems, and contingency funding plans

**Interest Rate Risk**...the adequacy of a bank's IRR program is dependent on its ability to **identify, measure, monitor, and control** all material interest rate exposures.

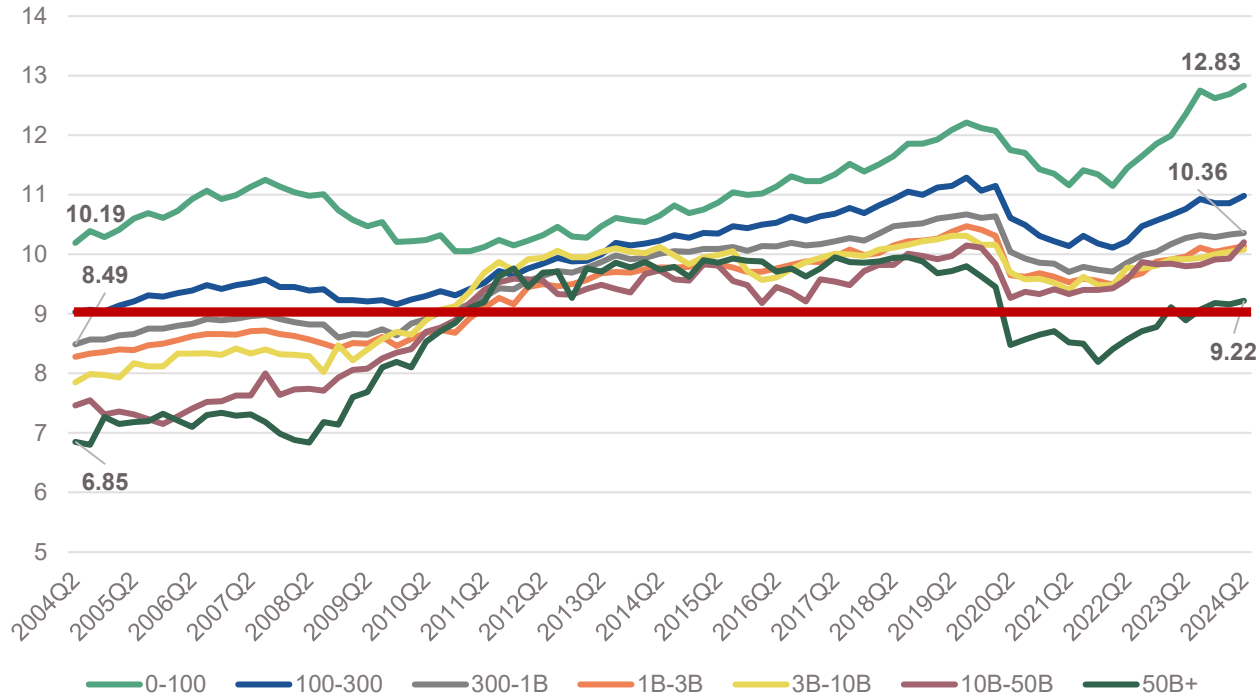
# **Regulatory Relationship Killers**

# Killer 1: Not Enough Capital

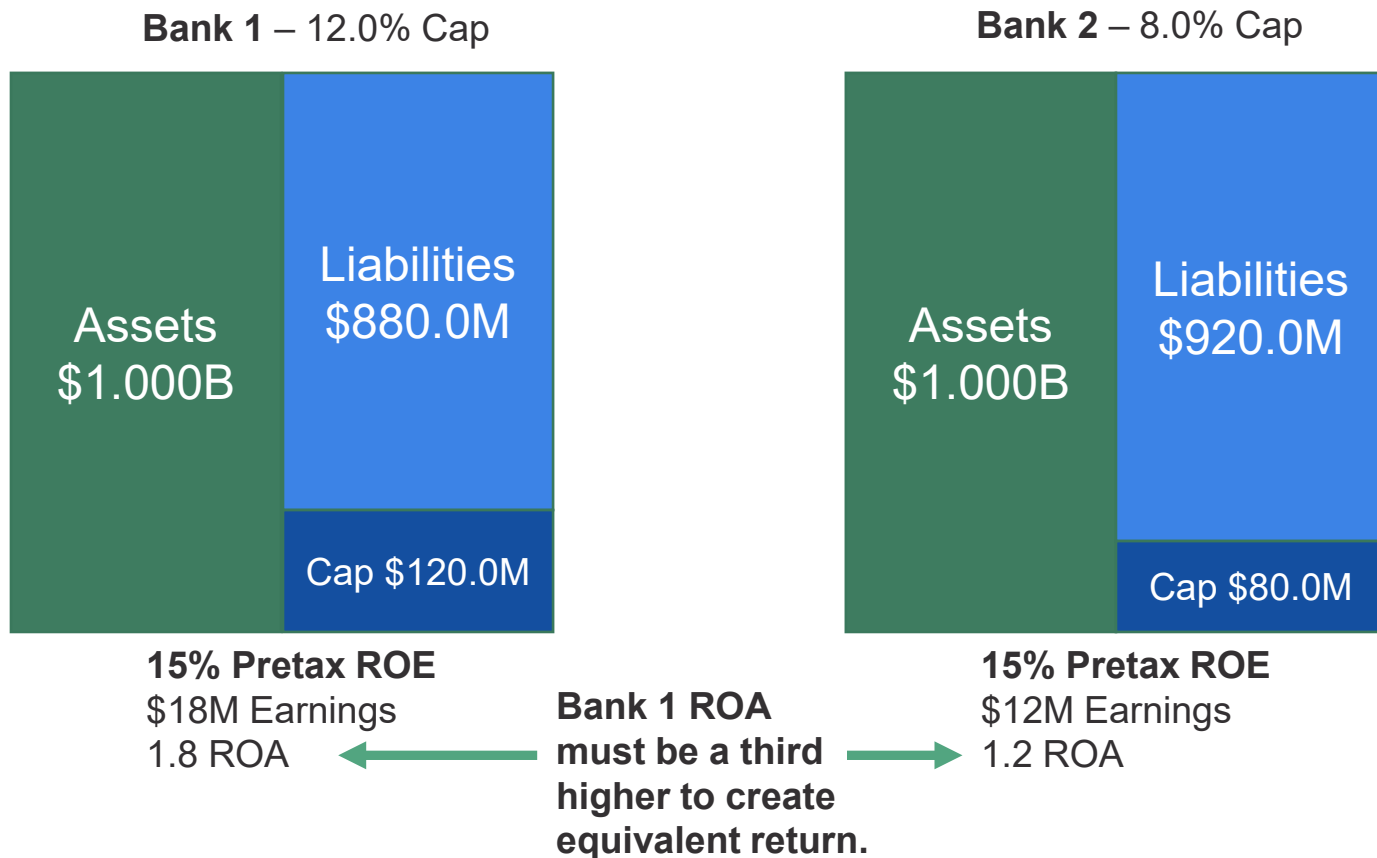
# Not Enough Capital

Capital Levels Higher

### Tier 1 Leverage Ratio Median By Asset Size



# WHAT IS THE RIGHT AMOUNT OF CAPITAL



# Not Enough Capital

## Capital at Risk Lower

OCC Bulletin 2012-33 | October 18, 2012

### Community Bank Stress Testing: Supervisory Guidance

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See [OCC Bulletin 2021-21](#), which explains that the stress test tool for income-producing CRE loan portfolios has been terminated and is no longer on the OCC's BankNet website.

#### Purpose

The Office of the Comptroller of the Currency (OCC) is issuing Bulletin OCC 2012-33, "Community Bank Stress Testing: Supervisory Guidance," to provide guidance to national banks and federal savings associations (collectively, banks) with \$10 billion or less in total assets on using stress testing to identify and quantify risk in loan portfolios and help establish effective strategic and capital planning processes.

Community banks, regardless of size, should have the capacity to analyze the potential impact of adverse outcomes on their financial conditions. The OCC's guidance describes various types of stress test methods that community banks may use and provides one example of a simple stress test framework to consider. The OCC encourages community banks to adopt a stress test method that fits their unique business strategy, size, products, sophistication, and overall risk profile.

Bank management and examiners should use this guidance in conjunction with the "Concentrations of Credit" booklet in the OCC's *Comptroller's Handbook* series, OCC Bulletin 2012-16, "Guidance for Evaluating Capital Planning and Adequacy," and the Interagency Final Guidance on "Concentrations in Commercial Real Estate Lending, Sound Risk Management Practices." These documents provide additional information on stress testing objectives and methods.

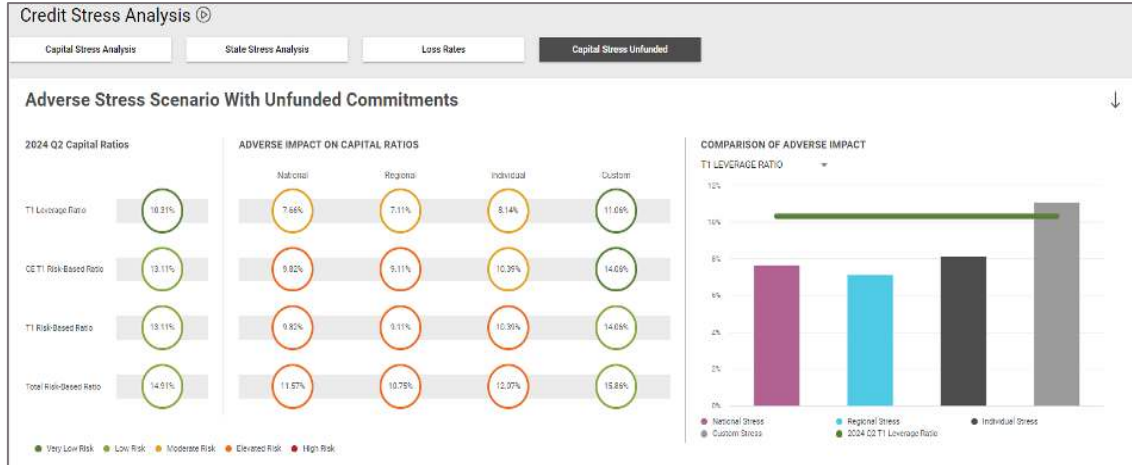
#### Background and Supervisory Expectations

The recent financial crisis demonstrated how unexpected economic downturns and rapid deterioration in market conditions can significantly harm a bank's financial condition and economic viability. Concentrations of credit, particularly in commercial real estate (CRE) loans for acquisition, construction, and land development purposes, have been a common factor in bank failures during stressful periods, especially for community banks. Other factors that have played a role in weakened bank conditions and failures include inadequate capital, dependence on brokered deposits, and dependence on assets whose valuations are highly sensitive to volatility in energy and commodity prices, interest rates, or farmland prices.

Sound risk management practices should include an understanding of the key vulnerabilities facing banks. For several years, supervisors have used the term "stress testing" in guidance and handbooks to refer to and encourage banks to incorporate this practice. Well-managed community banks routinely conduct interest rate risk sensitivity analysis to understand and manage the risk from changes in interest rates. Many community banks, however, do not have similar processes in place to quantify risk in loan portfolios, which often are the largest, riskiest, and highest earning assets.

#### To

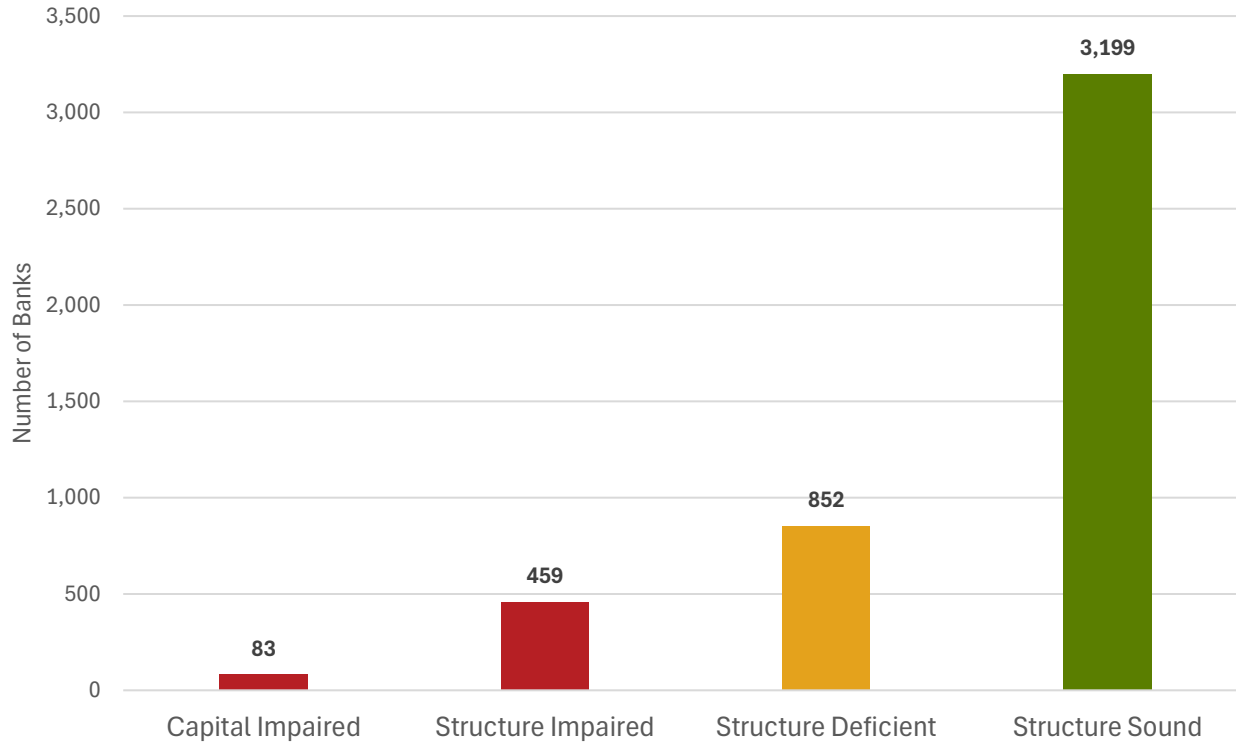
Chief Executive Officers of All National Banks, Federal Savings Associations, Department and Division Heads, Examining Personnel, and Other Interested Parties



# Not Enough Capital

*Capital at Risk Lower*

### Stress Positions 2Q 2024



# Killer 2: Concentrations



# Concentrations

## *What is a Concentration*

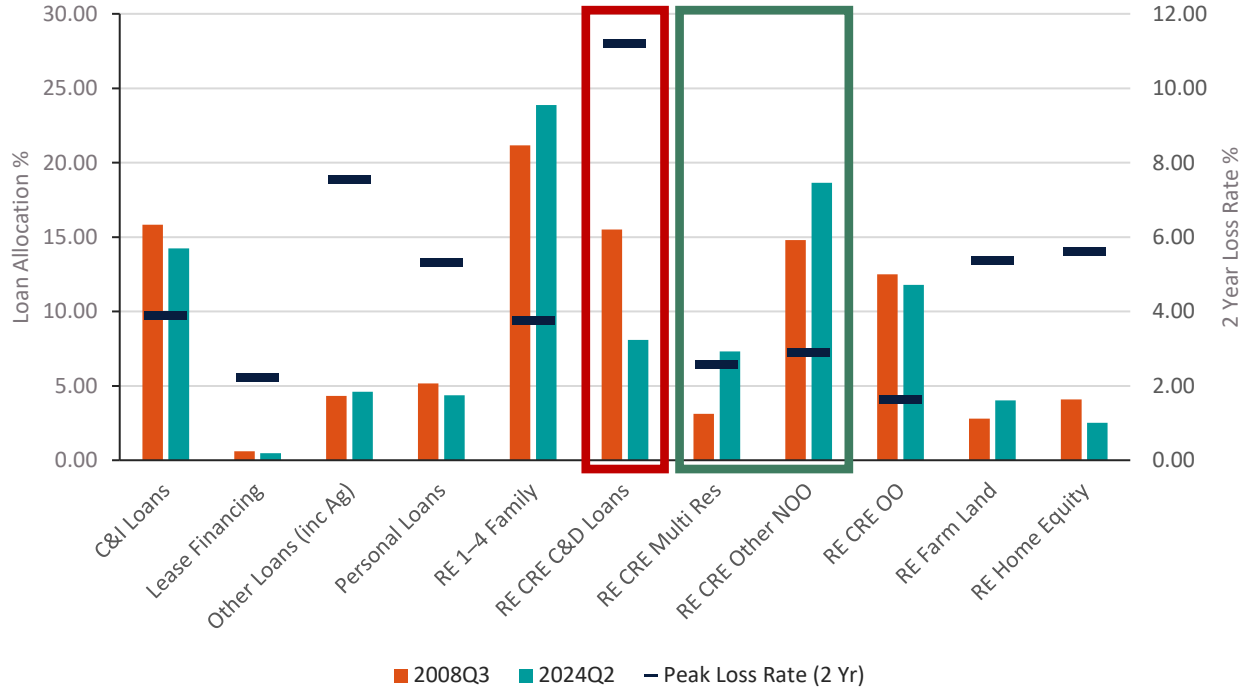
“A “concentration” is defined as the sum of direct, indirect, or contingent obligations exceeding **25 percent** of the bank’s tier 1 capital plus the ALLL or ACL, as applicable.”

“When a bank sets higher concentration limits for broadly defined pools—especially when those limits are more than **100 percent** of capital—sound concentration risk management typically includes setting appropriate **sublimits** for material groups of segmented exposures.”

# Concentrations

## Loan Portfolio Shifts

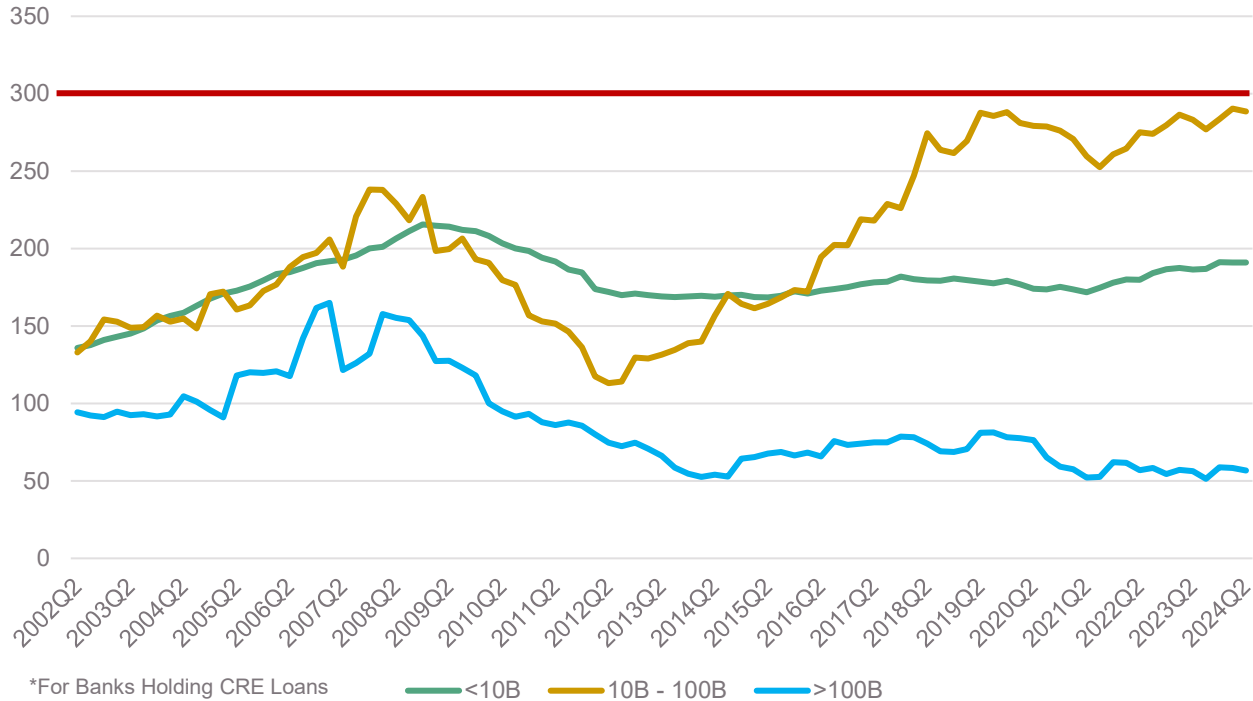
Loan Portfolio Allocation & Peak Loss Rate  
Banks <10B, Exc. Credit Card Loans



# Concentrations

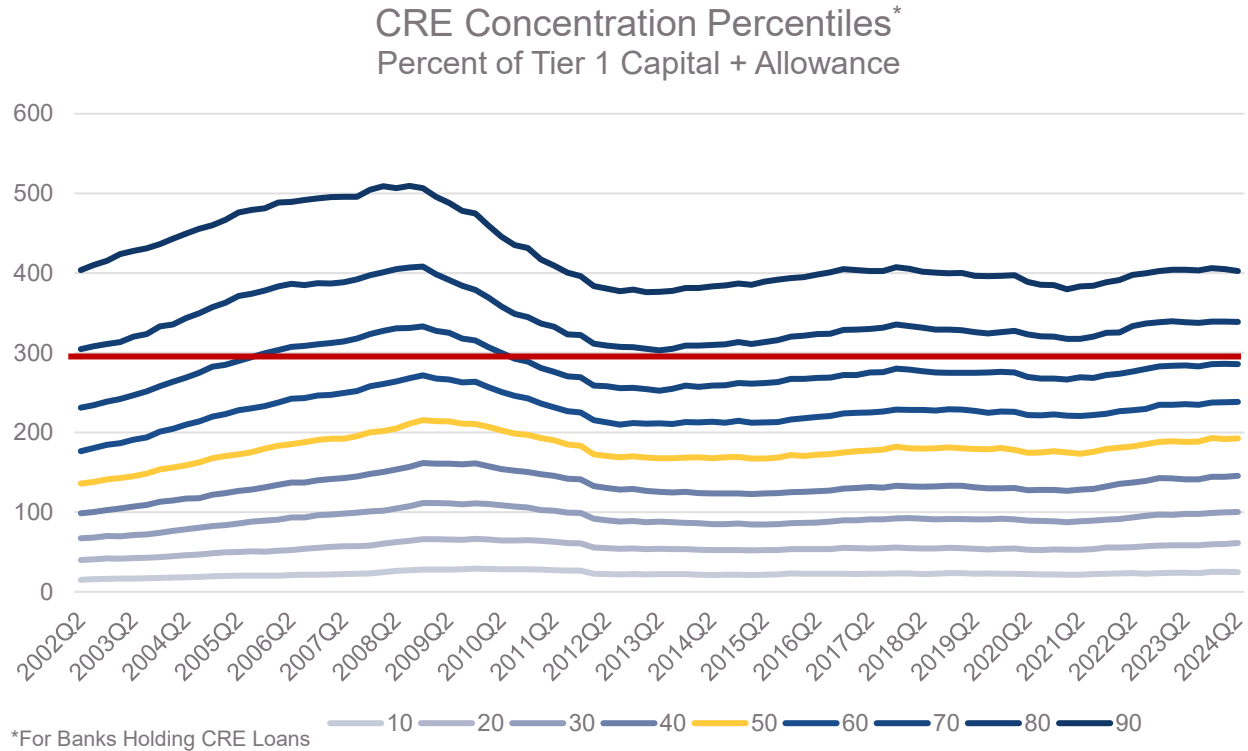
## CRE Concentrations

CRE Concentrations by Asset Size\*  
Median Percent of Tier 1 Capital + Allowance



# Concentrations

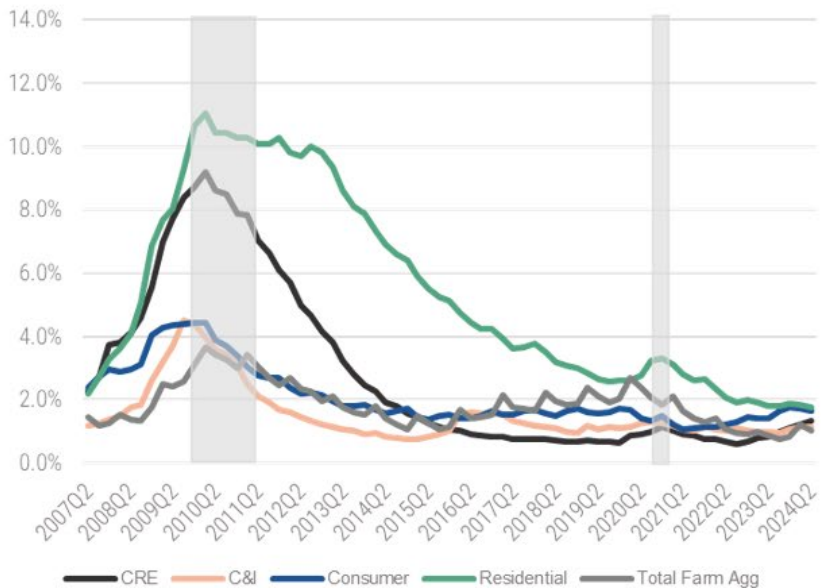
## CRE Concentrations



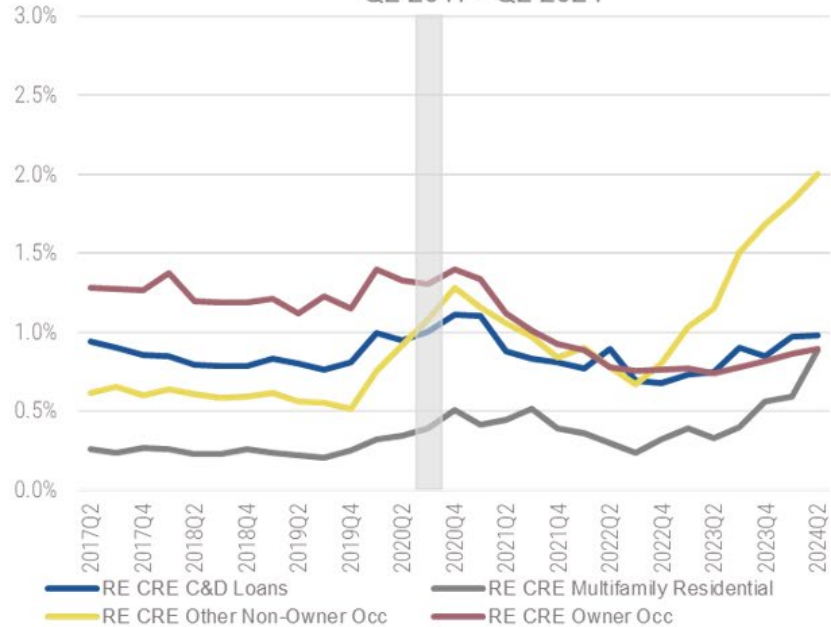
# Concentrations

## Loan Performance

### Aggregate Delinquency Rates (%)



### CRE Delinquency Rates (%) Q2 2017 - Q2 2024



# Concentrations

Segmentation is KEY!!!

## Categories

- CRE C&D
- CRE Multi-Family
- CRE Non-Owner
- CRE Owner-Occ

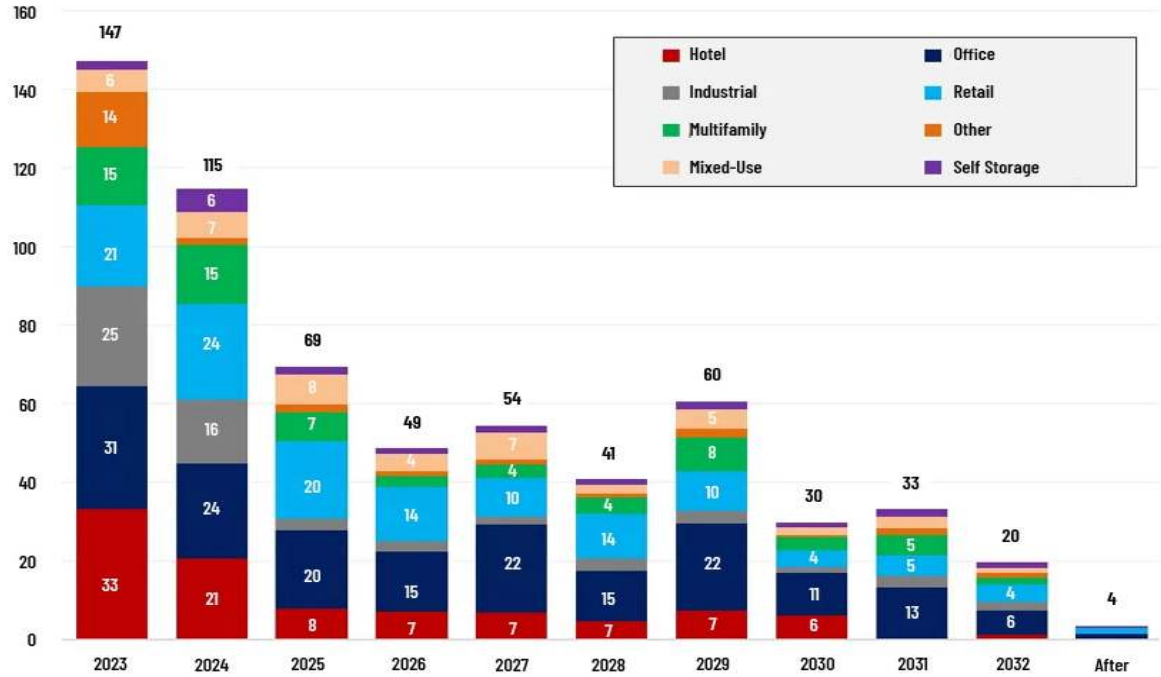
## Loan Types

- Permanent Mortgage
- Bridge Loan
- Construction
- Mezzanine

## Loan Terms

- LTV
- Guarantee
- Rate
- Maturity

CMBS Maturity Schedule as Of 3/17/2023 (Conduit + SASD, \$ billions)

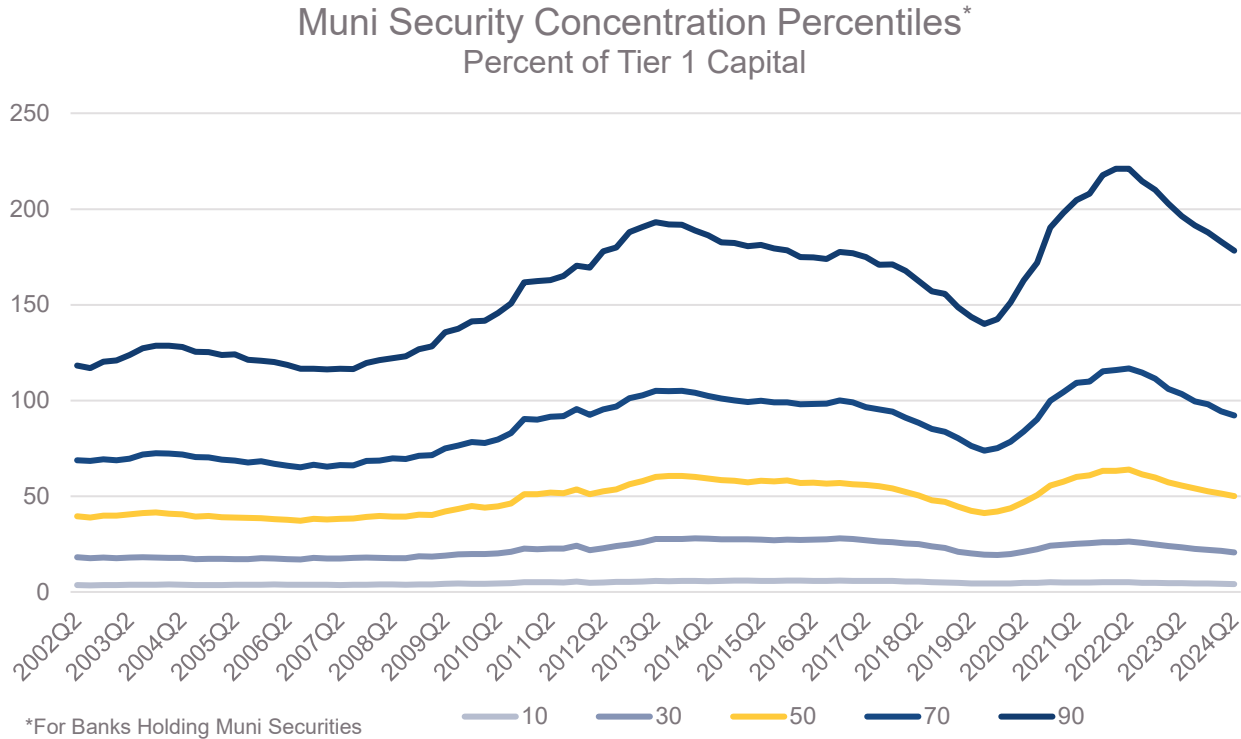


Source: Trepp

# What about Security Concentrations?

# Concentrations

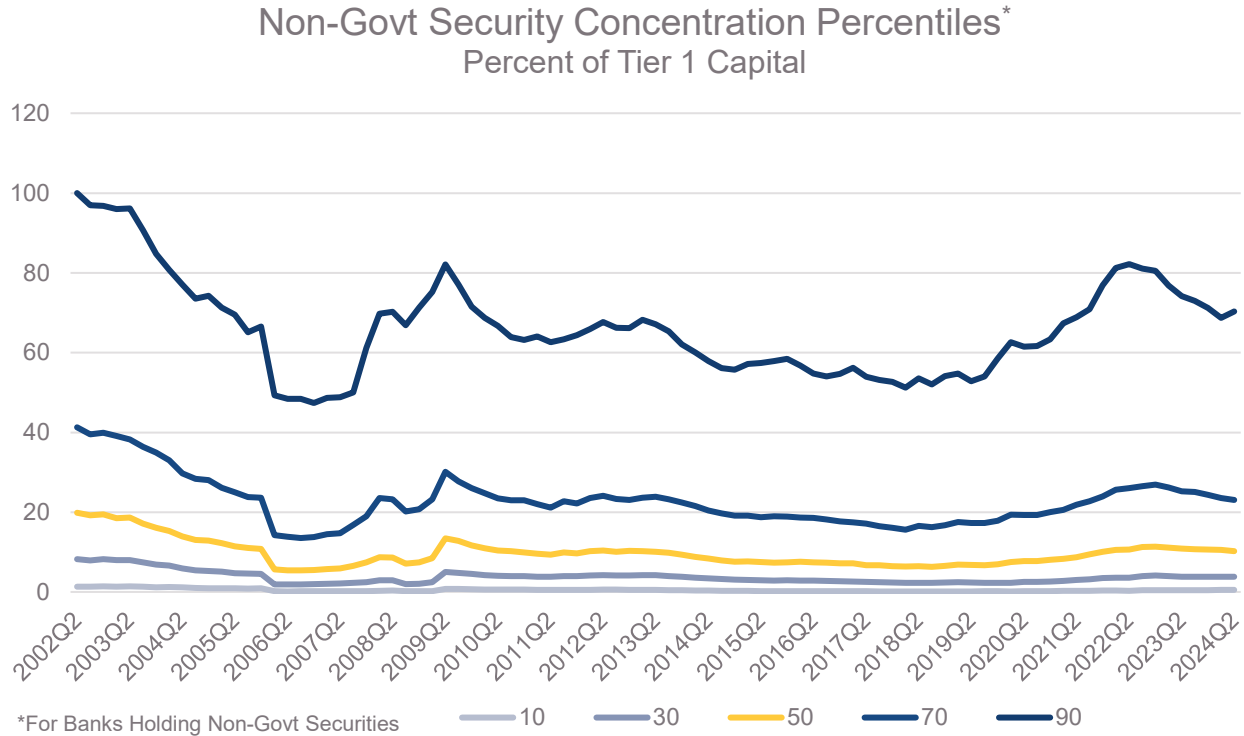
## Capital at Risk Lower





# Concentrations

## Capital at Risk Lower



# Concentrations

## Capital at Risk Lower



### Portfolio Diversification Guidelines

#### Securities

##### Direct and Indirect Obligations Guaranteed by the United States Government

1. US Treasury Bills, Bonds, and Notes
2. Direct Debt Obligations of U.S. Agencies
3. Mortgage-Backed Securities issued by U.S. Agencies
4. Collateralize Mortgage Obligations Issued by U.S. Agencies
5. U.S. Agency Securities backed by Home Equity Conversion Mortgages
6. Structured Notes and Callable Agency Securities
7. Other Securities Issued by U.S. Agencies
8. Mutual Funds made up of U.S. Obligations

##### Obligations Not Guaranteed by the United States Government

1. Obligations of U.S. State or Political subdivisions (General Obligation)
2. Obligations of U.S. State or Political Subdivisions (Essential Purpose Revenue)
3. Obligations of U.S. State or Political Subdivisions (Pledged Revenue Bond)
4. Obligations of U.S. State or Political Subdivisions (Other Revenue Bond)
5. Privately Issued 1-4 Family Mortgage-Backed Securities
6. Privately Issued Commercial Mortgage-Backed Securities
7. Privately Issued Asset Backed Securities
  - » Student Loans Backed by Federal Education Loan Program (FELP)
8. Debt Obligations of Private Corporations
9. Debt Obligations of Insured Depositories
10. Stock Holdings Permissible for a National Bank
11. Community Reinvestment Act Investments

##### Money Market Instruments

1. Fed Funds Sold
2. Term Fed Funds Sold
3. Insured Certificates of Deposit
4. Uninsured Certificates of Deposit
5. Reverse Repurchase Agreements
6. Commercial Paper
7. Banker's Acceptances

##### Footnotes:

1. The sum of all non-government obligations in categories 1 through 4 will not exceed 50% of the total portfolio or 200% of Tier 1 capital.
2. The sum of all non-government obligations in categories 5 through 6 will not exceed 50% of the total portfolio or 100% of Tier 1 capital.
3. The sum of all non-government obligations in categories 7 through 10 will not exceed 50% of the total portfolio or 100% of Tier 1 capital.
4. Limitations on Stock Holdings will be based on the permissible limit for each investment, with the maximum not to exceed 10% of Tier 1 capital.

### Obligations Not Guaranteed by the United States Government

1. Obligations of U.S. State or Political subdivisions (General Obligation)	50% <sup>1</sup>	200% <sup>1</sup>
2. Obligations of U.S. State or Political Subdivisions (Essential Purpose Revenue)	50%	100%
3. Obligations of U.S. State or Political Subdivisions (Pledged Revenue Bond)	50%	100%
4. Obligations of U.S. State or Political Subdivisions (Other Revenue Bond)	25%	100%
5. Privately Issued 1-4 Family Mortgage-Backed Securities	25% <sup>2</sup>	100%
6. Privately Issued Commercial Mortgage-Backed Securities	25%	100%
7. Privately Issued Asset Backed Securities <ul style="list-style-type: none"> <li>» Student Loans Backed by Federal Education Loan Program (FELP)</li> </ul>	25% <sup>3</sup>	100%
8. Debt Obligations of Private Corporations	25%	100%
9. Debt Obligations of Insured Depositories	25%	25%
10. Stock Holdings Permissible for a National Bank	25%	10% <sup>4</sup>
11. Community Reinvestment Act Investments	25%	20%

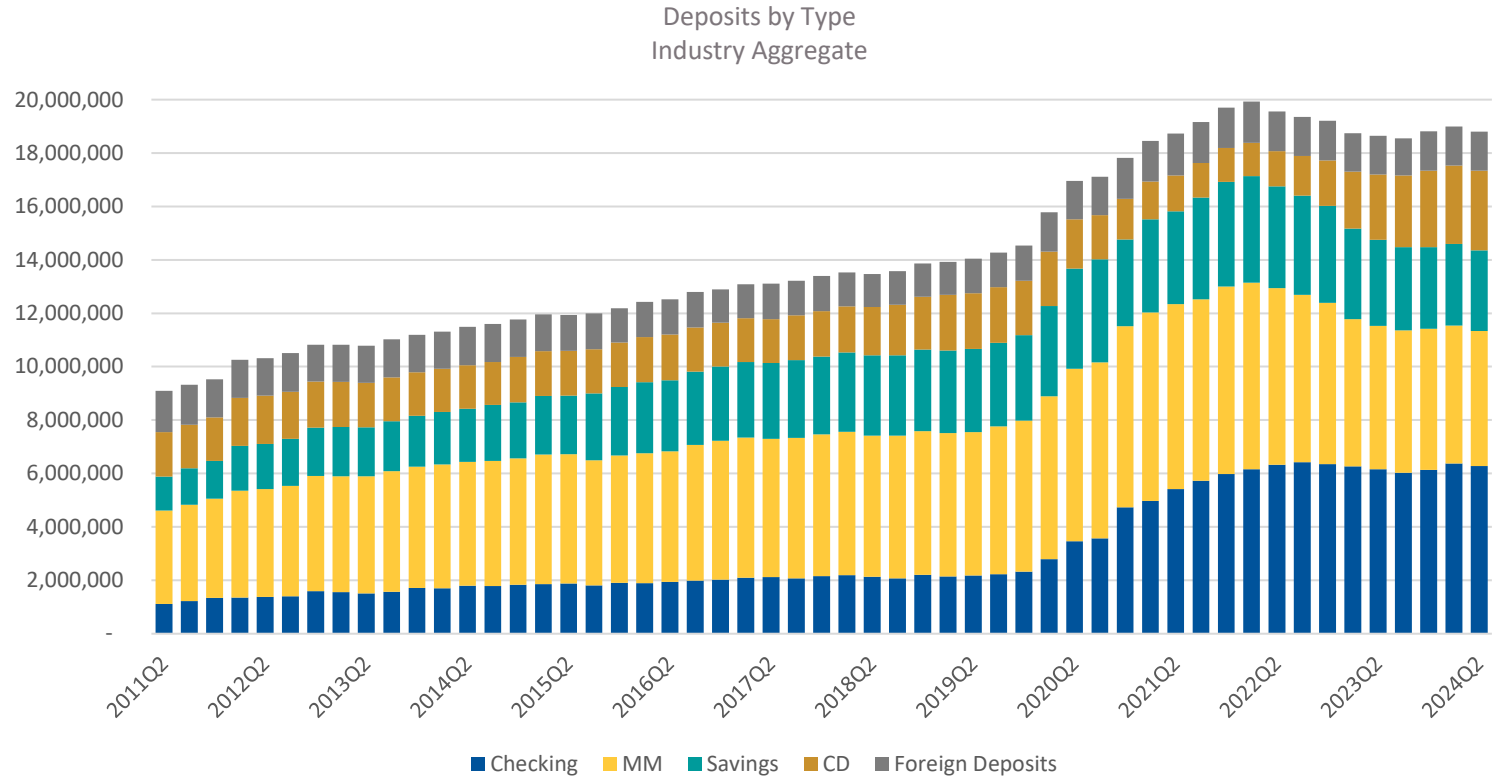
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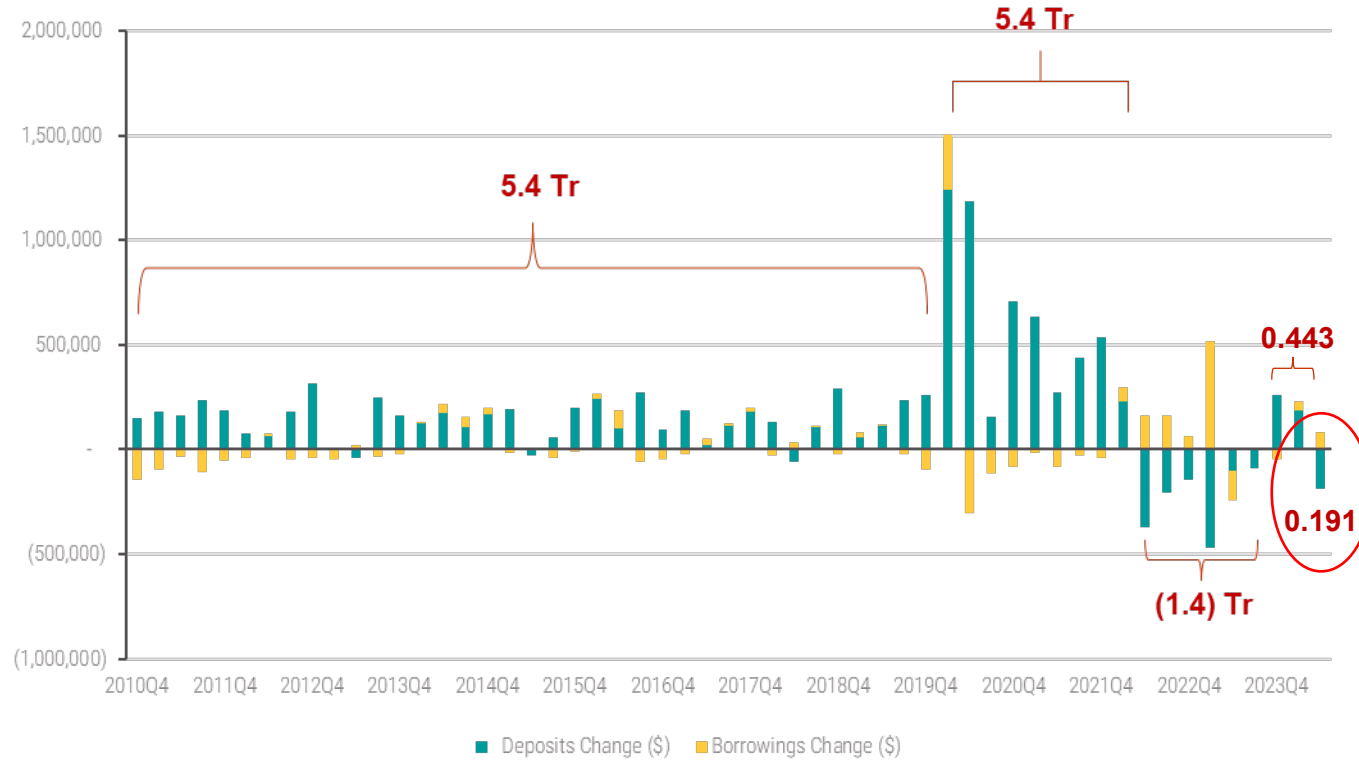
# Killer 3: Non-Core Deposits

# Core Deposits

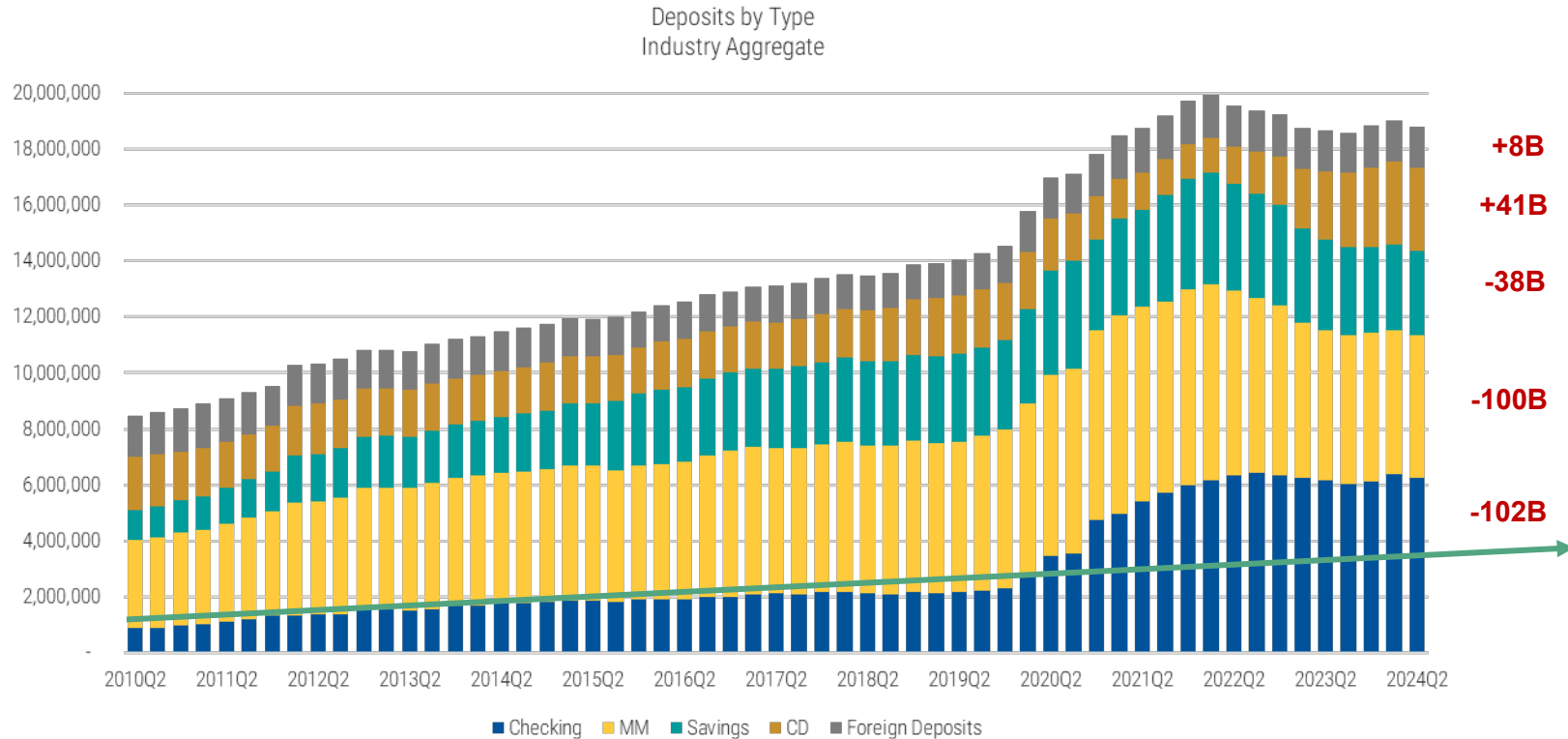
Capital at Risk Lower



# Bank Deposits



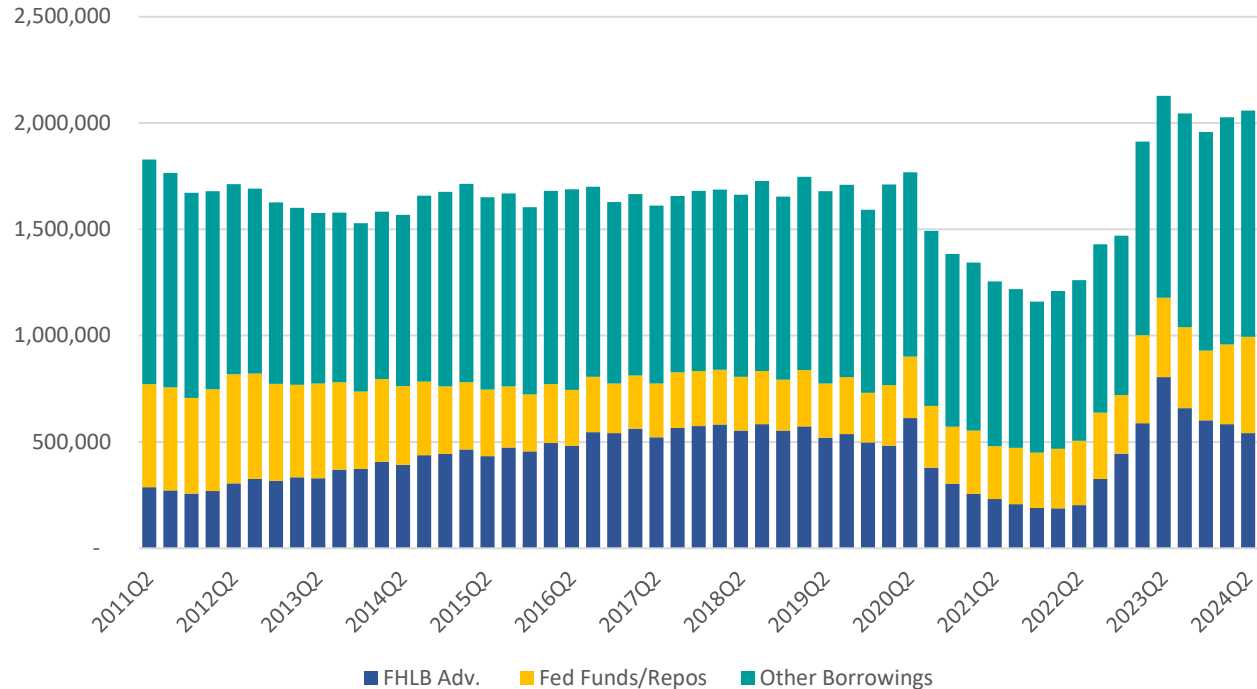
# Deposit Composition = DDA!



# Core Deposits

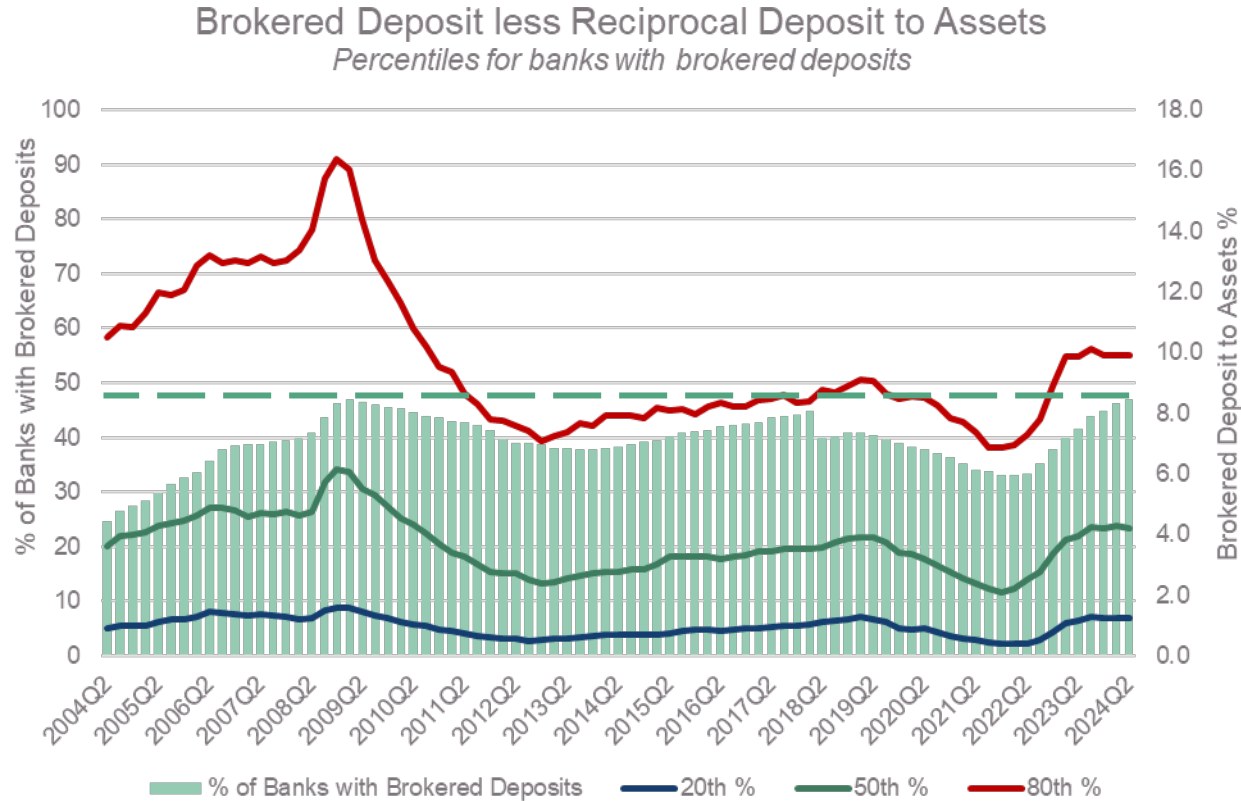
Capital at Risk Lower

## Wholesale Borrowing by Type Industry Aggregate



# Funding Challenges

More Banks are Utilizing Brokered Deposits

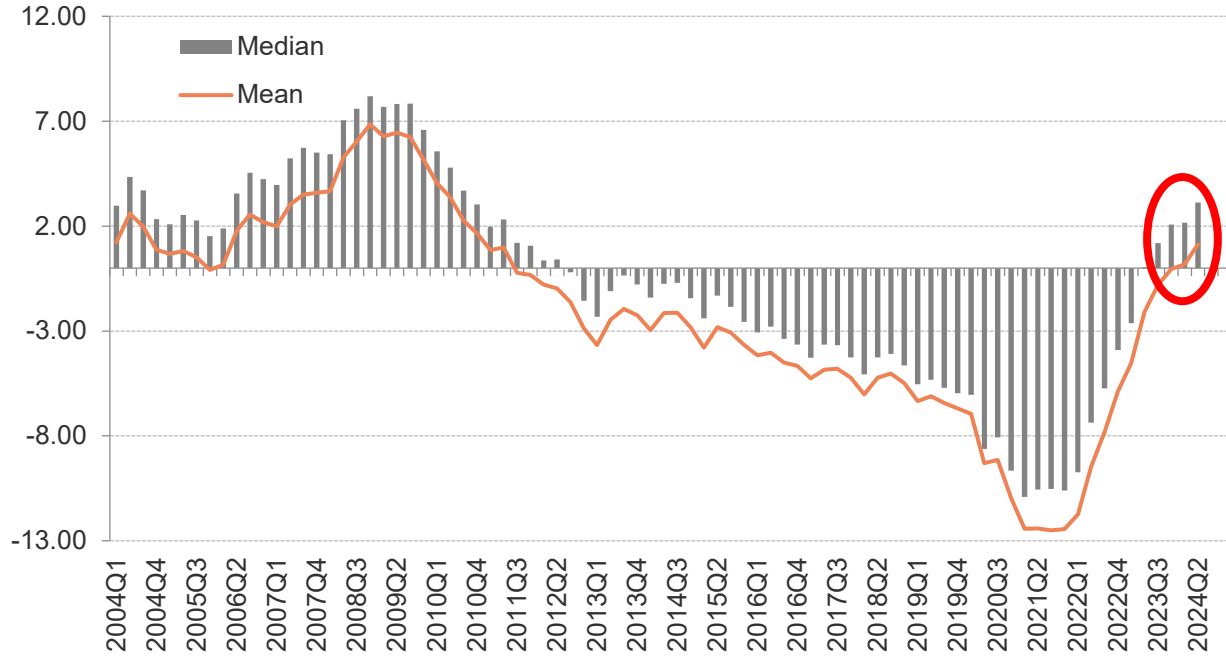




# Funding Challenges

Deposit Levels Shorter

## Net Short-Term Liabilities to Assets



# Core Deposits

## Capital at Risk Lower

*“The FDIC’s examination program views brokered deposits at well capitalized institutions as being subject to the same considerations and concerns as any other type of funding. The guidance explicitly states that there should be no stigma attached to the acceptance of brokered deposits per se and that the proper use of such deposits should not be discouraged.”*



## The Truth About Brokered Deposits

November 1, 2023

In a recent speech, FDIC Vice Chairman Travis Hill made some interesting remarks about brokered deposits. Citing the liquidity events from earlier in the year, Mr. Hill noted that “while some uninsured deposits, at the risk of loss in the event of failure, moved extremely quickly this spring, perhaps the stickiest of deposits proved to be brokered certificates of deposit.”

Even though Mr. Hill conceded long-standing regulatory reservations about brokered funding, he recognized that “because the depositors have no relationship with the bank, earn high rates, are fully insured, and generally cannot withdraw before maturity, the deposits are extremely sticky, and the depositors are indifferent to whether the bank has a future or not. **Far from being “hot money,” these deposits are so cold they are virtually frozen in place.**”

Do these comments suggest that the cold shoulder regulators have shown toward brokered deposits is starting to thaw? Probably not, as we expect regulators will continue to have reservations about how brokered deposits are administered in the context of a bank’s strategic intentions. However, we don’t believe these reservations justify the negative stigma that is generally associated with brokered funds. In the proper context, there are several specific circumstances where the use of brokered deposits can play a positive and effective role in managing a bank’s overall funding

positions. The following comments are intended to provide general guidance on the opportunities and the conditions where the use of brokered deposits may be an appropriate option for your organization.

### What is the definition of a brokered deposit?

The definition of a brokered deposit is specifically guided by bank regulation. Section 29 of the Federal Deposit Insurance Act is the statutory rule that places restrictions on the use of brokered funds. The rule was first enacted in 1989, and it has undergone a number of revisions since that time to address changes in banking law and the evolving environment for deposit and funding activity. The implementing regulation that guides and defines the specific rules associated with brokered is Part 3376 of the FDIC’s Rules and Regulations. The latest version of Part 3376 became effective on April 1, 2021, and is currently the outstanding rule that governs the use of brokered deposits in banking.

Section 29 and Part 3376 do not create a specific definition for the term “brokered deposit.” Instead, the rules provide definitions for what constitutes a “deposit broker.” Any deposit that comes from a defined “deposit broker” is, in turn, considered a “brokered deposit” for statutory purposes. The term “deposit broker” is specifically defined as (1) any person engaged in the business of placing deposits of third parties with insured depository institutions; (2) Any person engaged in the business of facilitating the placement of deposits of third parties with insured depository institutions; (3) Any person engaged in the business of placing deposits with insured depository institutions for the purpose of selling those deposits or interests in those deposits to third parties; and (4) 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. This definition is subject to nine specific statutory exceptions, which generally include interbank deposits and primary purpose exceptions.

**Don't Wait Until It's Too Late!!!**

# PT Score



## Taking the Right Kinds of Risk with PT Score®

### What is the PT Score®?

PT Score® is a **Strategic Risk Management System** that helps financial institutions optimize performance through more effective management of risk and regulatory positions.

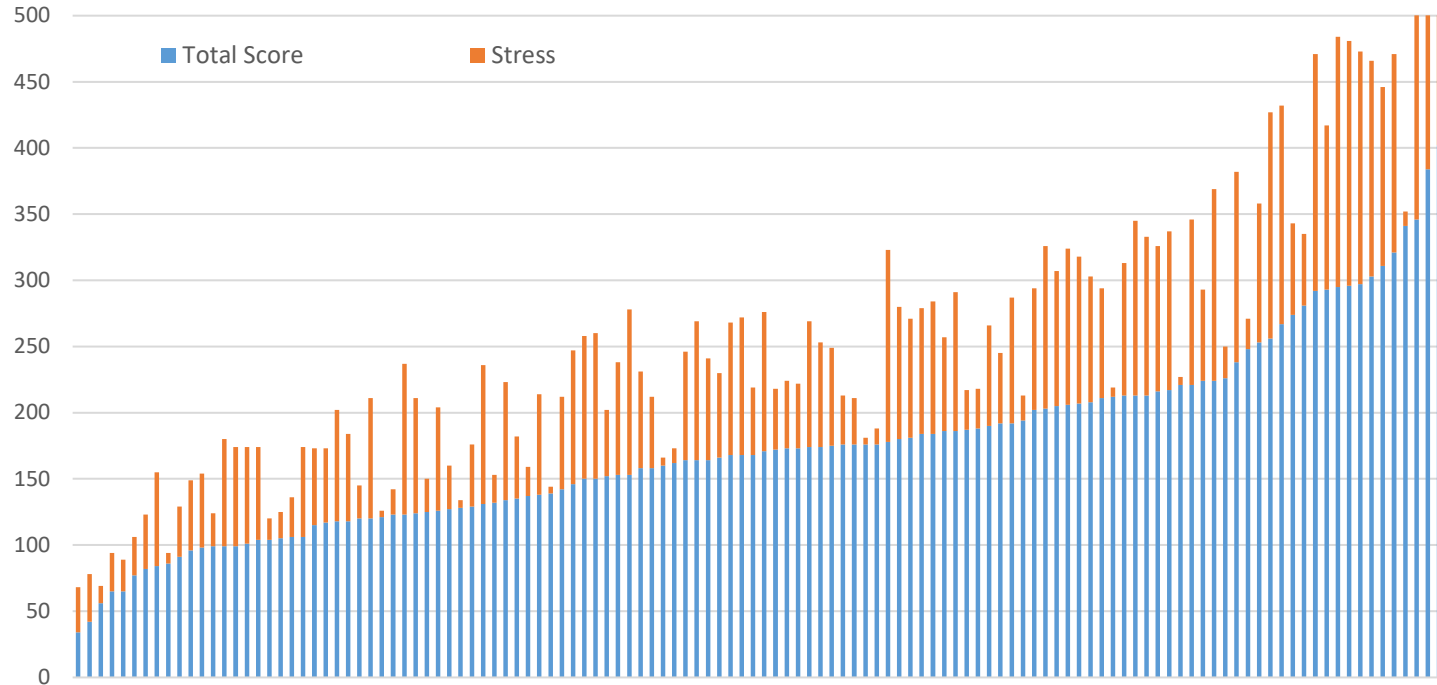


# PT Score



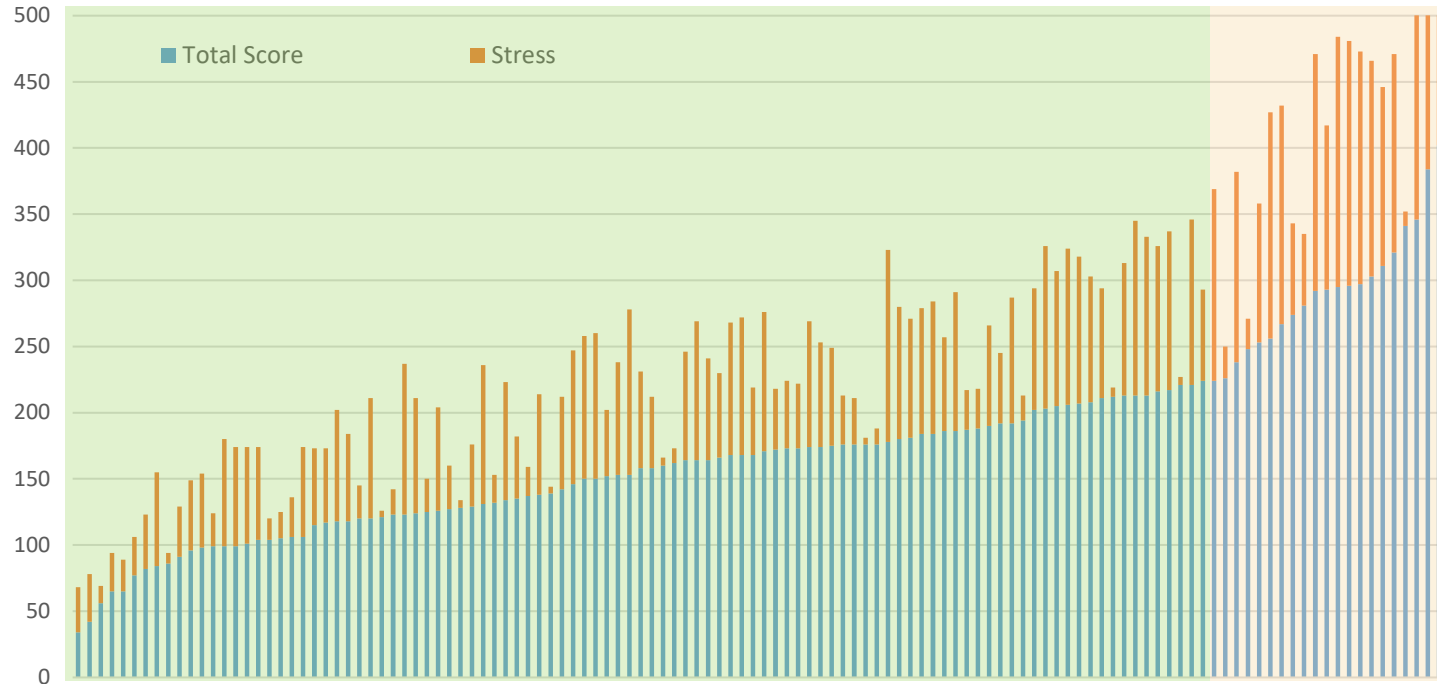
# Taking the Right Kinds of Risk with PT Score<sup>®</sup>

## Tennessee Bank PT Scores and Stress Adjusted Scores



# Taking the Right Kinds of Risk with PT Score<sup>®</sup>

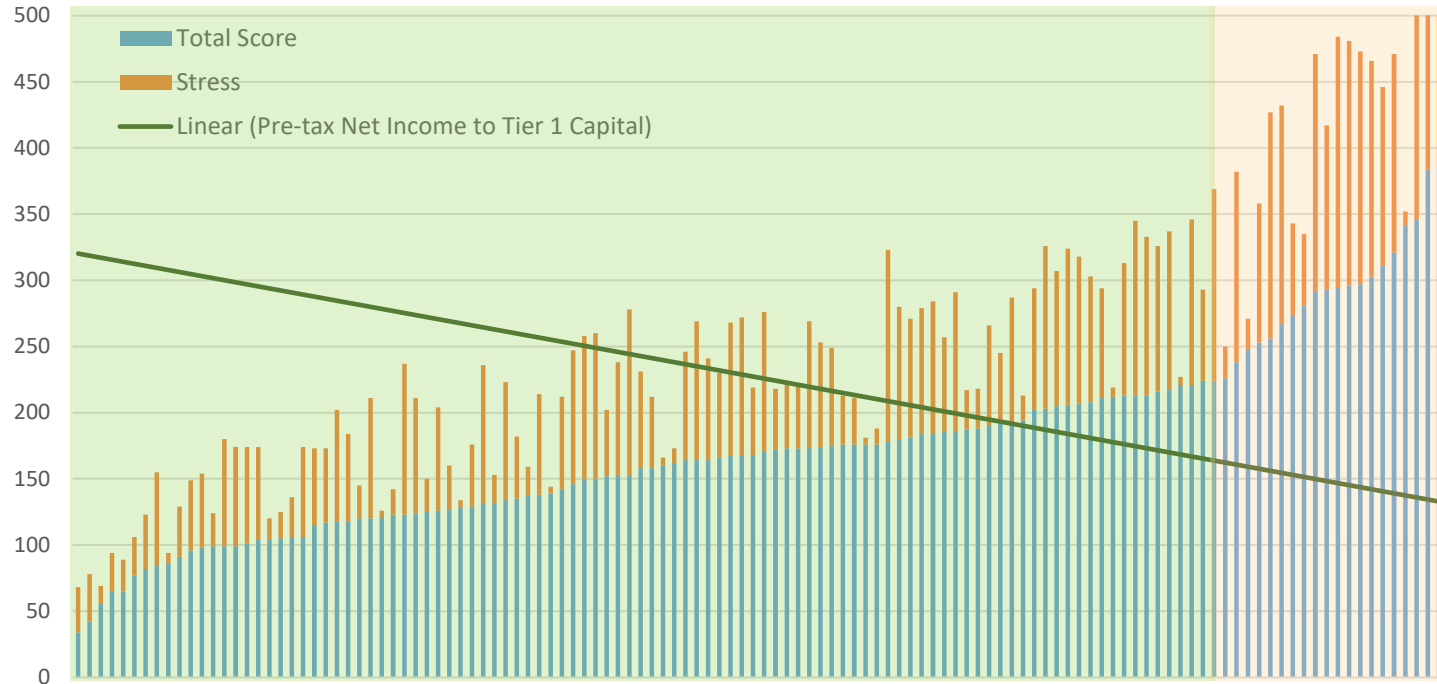
## Tennessee Bank PT Scores and Stress Adjusted Scores





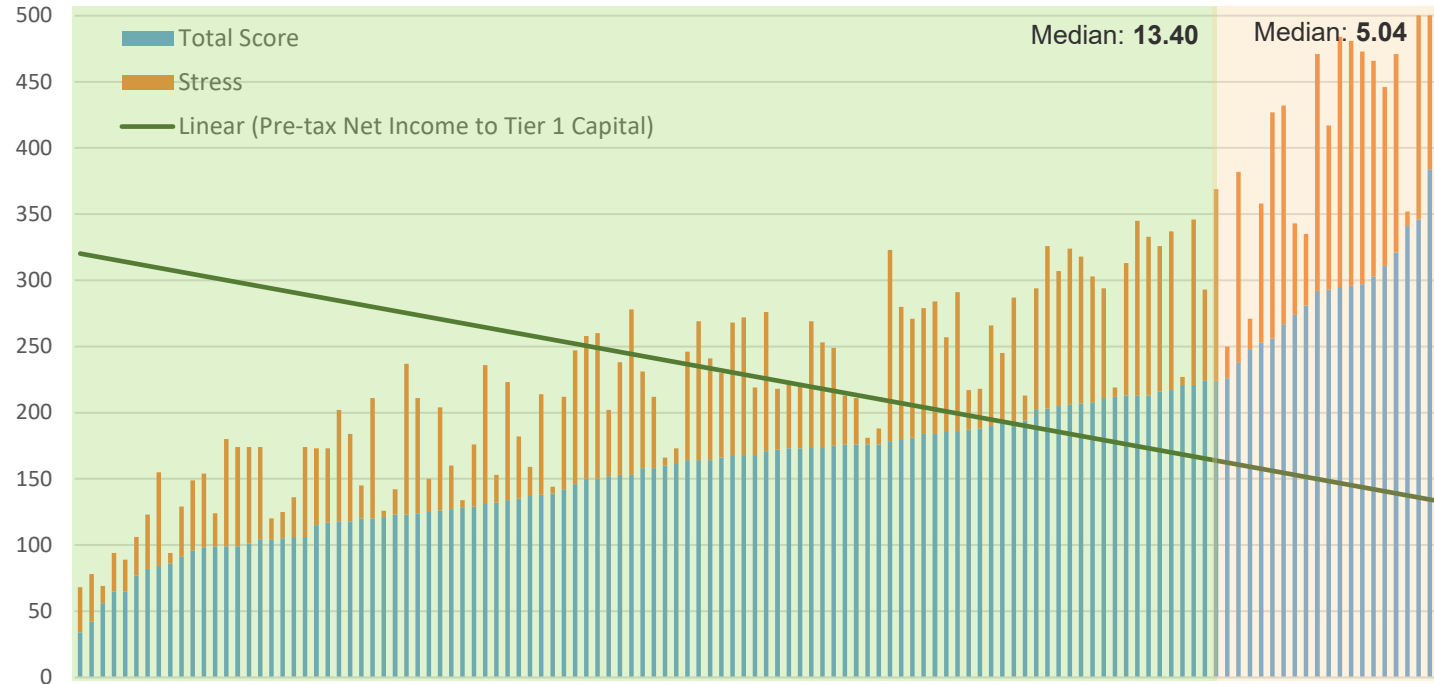
# Taking the Right Kinds of Risk with PT Score<sup>®</sup>

## Tennessee Bank PT Scores and Stress Adjusted Scores



# Taking the Right Kinds of Risk with PT Score<sup>®</sup>

## Tennessee Bank PT Scores and Stress Adjusted Scores





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