Office of the Comptroller of the Currency
Minutes of the Meeting of the
Mutual Savings Association Advisory Committee
May 3, 2016

The Mutual Savings Association Advisory Committee (MSAAC) was convened for a meeting at 8:30 a.m. on May 3, 2016, at the Office of the Comptroller of the Currency (OCC), 400 Seventh Street S.W., Washington D.C. 20219.

In accordance with the provisions of Public Law 92-463, the meeting was open to the public from 8:30 a.m. to 3:00 p.m.

Advisory Committee Members Present

Jeff Hyde, Thomas Kemly, Dan Moore, Susan Ralston, Steven Swiontek, Charles Timpa

OCC Staff Attending

Comptroller of the Currency Thomas J. Curry, Charlotte Bahin, Toney Bland, Michael Brickman, Arnie Cohen, Ralph DeLeon, Kevin Greenfield, Kris Kiefer, Beth Knickerbocker, Ernie Knott, Wendell Walker

Public Meeting

Michael Brickman, the OCC's Deputy Comptroller for Thrift Supervision and the committee's Designated Federal Officer called the meeting to order and welcomed attendees at 8:35 a.m. He introduced Thomas J. Curry, Comptroller of the Currency.

Comptroller Curry welcomed the committee members and thanked them for their time and commitment. He gave an overview of matters of interest that had occurred in the past two weeks. The Comptroller described a speech that he had given before the UK Building Societies. He remarked that many of the issues are the same as those confronted by mutuals in the United States. Toney Bland, Senior Deputy Comptroller for Midsize and Community Bank Supervision, also made welcoming remarks.

Mr. Brickman gave a brief overview of recent discussions held by the OCC's National Risk Committee and described the categories of risk that would be focused on in community bank examinations. The five categories he highlighted were: credit risk, strategic risk and governance, operational risk, compliance risk, and interest rate risk. A committee member remarked that in his geographic area, the aggressive terms found in real estate lending transactions are similar to those found a number of years ago and another member said that competition for transactions is very tough. Mr. Brickman said that the OCC's National Risk Committee is concerned about the trends and is looking at the data from Matters Requiring Attention (MRA) in the credit risk area. He said that the OCC is holding banks accountable in each exam but that the agency is seeing erosion of underwriting. Comptroller Curry reminded the committee that the CRE guidance issued in 2006 was a signal to the industry to be aware of concentrations.

Mutual Federal Savings Association Financial Performance

Ernie Knott, Financial Analyst, Northeastern District gave a presentation highlighting financial trends for federal mutual savings associations. The financial data shown in the presentation are from the December 31 Call Report. Also included is trend information about mutuals. The presentation began with a high level review of the portfolio of federal mutual savings associations supervised by the OCC. Mr. Knott went through the slides in his presentation and highlighted trends in loan growth, capital levels, efficiency ratios and other metrics. A committee member asked whether as part of the possible changes to the Call Report, the OCC is considering including additional metrics showing more detail that would be useful in measuring interest rate risk. He said that the Thrift Financial Report required by the OTS required more gradations of loan categories and he had found it useful in measuring interest rate risk. Mr. Knott explained that the focus of the Call Report simplification project is to reduce the number of items and that the current trend is for institutions to build or get their own models for interest rate risk.

Mr. Knott described the trends in the component ratings and highlighted that in the aggregate, the earnings component has improved from last year. He remarked that he believes that this is as a result of the issuance of the mutual guidance in 2014. Several committee members asked questions about how the earnings component is viewed by examiners and asked about the distinction between mutual and stock institution earnings. Another committee member said that he has had ongoing discussions with examiners and does not think they understand the 2014 guidance. Mr. Brickman suggested that the issue may be more isolated but that it is not an OCC-wide issue.

Another member remarked that there is an understanding of the differences with examiners in his District. He added that the examiners also understand the philanthropic giving that his institution does. Wendell Walker, Assistant Deputy Comptroller in the Nashville Field Office, pointed out that the education of the examiners about the risk profile of mutuals and what examiners expectations should be is an ongoing process. Mr. Knott agreed that education is important and reminded the group of the possibility to get a mutual only uniform bank performance report. Several members of the committee talked about the importance of examiners understanding and acknowledging the philanthropic programs and giving that mutuals do in their communities. Mr. Brickman pointed out that the strategic plan as approved by the board of directors should reflect the philanthropic activities and goals of the institution.

Mr. Knott commented that the quality and sources of earnings are important as is the adequate provision for the allowance for loan and lease losses and the impact of the allowance on earnings. Mr. Brickman said that the OCC’s National Risk Committee had a discussion about the allowance and looked at the trends. He said that individual banks should look at the methodology they use to do the calculation. A committee member discussed the calculation of the allowance using historical data. Another committee member talked about the differences between the calculations of the examiners and the accountants as the reason that the calculation changes.

Mr. Knott turned to a discussion of the quality of risk and the risk assessment guidance issued in 2015. He described the results for mutuals and highlighted that there is an additional category between “weak” and “satisfactory.” “Insufficient” has been added. He reminded the committee that the risk assessments are forward looking and that risk management can affect the condition of the bank if it is not corrected. A member of the committee noted that reputation risk has increased and he asked what has changed to increase the risk. Mr. Knott replied that possible reasons are a focus on operational risk and Bank Secrecy Act. Mr. Brickman suggested that perhaps a change to the methodology was the reason. He followed by saying that examiners are looking more closely at reputation risk. Another member asked how to reconcile some of the elevated concerns about different risks and Mr. Brickman suggested looking at the risks separately. Mr. Knott added that “resilience” has been added to reputation risk.

Mr. Knott pointed out that that most frequently cited MRA is for credit. A member of the committee asked how an institution can attain a 1 rating in Information Technology (IT) given the heightened emphasis on reputation risk and cybersecurity. Mr. Knott noted that the use of the Cybersecurity Assessment Tool (CAT) by examiners may result in additional IT MRAs. He clarified that the MRAs would not be as a result of the use of the CAT but rather as a result of findings from an IT examination. Mr. Brickman mentioned the significant impact that one failure in the IT area can have on an institution and its reputation. Generally it is very different from the failure of one loan. Mr. Knott concluded the discussion by noting that he is working on a document for examiners to show how to run peer groups for mutuals.

Technology and Cybersecurity Update

Kevin Greenfield, the Director of Bank Technology, Operational Risk Policy, provided an overview of emerging risk trends in the technology area, specifically trends in cybersecurity. Mr. Greenfield reminded the committee members that cybersecurity is a threat to all industries, not just banking or financial services. Existing vulnerabilities continue to be exploited. This might include attacking a server that was not patched. Malicious actors are persistent and innovation creates its own potential risks. Technology is moving forward dramatically but the use of technology changes controls. Banks should consider whether existing controls are adequate or appropriate and whether they function in an evolving technology environment. Creating a culture of security within the bank is critical. A committee member provided an example of an event that occurred at his institution. Instructions for a wire transfer were ostensibly sent by the Chairman of the Board. However, the Chairman of the Board did not have authority to send the instructions so they were questioned and the money was not wired. Mr. Greenfield reminded the committee members that all staff should be trained to comply with policies and procedures and that that training should be reinforced.

He reminded the committee members that the root causes of major events are frequently simple things. If there is a breach, there are costs involved as well as the loss of customers’ trust. Bad actors have become very sophisticated and skills and resources are available for hire. Mr. Greenfield noted that in the Annual Report of Verizon, it was noted that 80 percent of data breaches are financially motivated. The bad actors frequently look for the path of least resistance, they would rather steal than break or hack. He also noted that it is important to have a complete inventory of all IT assets. It is impossible to protect assets that a bank does not know it has.

Mr. Greenfield described the importance of oversight of third parties. He pointed out that every bank has third party relationships and the OCC examines third party service providers. Banks must be aware of the threat landscape and Mr. Greenfield encouraged committee members to become members of FS ISAC if they are not already members. He also discussed the importance of having an incident response framework and relationships with the FBI, Secret Service and law enforcement. Staff needs to know how to respond in the event of a breach. Law enforcement's priority will be to identify and catch the perpetrator and the bank's priority will be to ensure the bank can open and do business.

Risk management, oversight and governance play important roles at banks in efforts to guard against cyber attacks. Everyone in the organization is responsible for knowing what is going on and monitoring vulnerabilities.

A committee member asked about the use of the CAT and whether the OCC has any results that can be shared. Mr. Greenfield reminded the committee members that the use of the CAT is voluntary and he said that it is working very well. In addition to discussing the results of the CAT that management choses to complete, examiners will complete it and look at peer comparisons. The value of a bank completing it is that the results can be compared with the findings of examiners. It can be used as an assessment tool going forward. Mr. Greenfield also reminded the committee members that any violation cited is based on existing guidance not on any findings from using the CAT. The results are useful in having discussions with the boards of banks.

Mr. Greenfield told the committee members that the agencies are working on a CAT for third party service providers. It would include an assessment of cyber controls.

OCC White Paper on Responsible Innovation

Beth Knickerbocker, Counsel, Legislative and Regulatory Activities Division, provided background and an update on the OCC's Responsible Innovation initiative. Ms. Knickerbocker said that one purpose of the discussion with the committee members was to provide a high-level overview of paper and another was to obtain initial reactions and insights the committee members are willing to share.

Innovation has been a priority issue at the OCC for about a year, but the Comptroller announced the specific responsible innovation initiative more recently. There are a number of hot topics as part of the innovation discussion. It is a rapidly changing environment that includes emerging technology, attention to evolving customer needs and behaviors and the growing number of nonbank entities offering products traditionally offered almost exclusively by banks.

Ms. Knickerbocker reminded the committee members that the OCC has long supported efforts by banks to meet changing needs of customers and communities. The agency recognizes that in an environment of rapid and evolutionary change taking place, banks need to adapt quickly and it wants to support innovation because banks are vital to a thriving economy and stable financial system.

The Comptroller's initiative was developed as part of the OCC's strategic planning process and is focused on innovation and how the agency can improve its ability to support responsible innovation in the federal banking system. In order to get a baseline understanding, OCC staff consulted with banks, consultants and other stakeholders to understand the evolving landscape, trends, innovations and customer needs. OCC staff also thought about how to improve the agency's ability to move more quickly to evaluate what activities or structures require approval and to identify risks associated with those products or services. If it is determined that no approval is required to begin the activity, the goal is to respond quickly to questions and serve as a resource, and better understand innovation occurring in banks and impact on safety and soundness.

The OCC formed a cross functional team to gather information to gain a better understanding of innovation today and to develop a framework to consider and evaluate responsible innovation. Several themes emerged from the discussions including the pace of technological change, how customer demographics and views affect innovations and how regulators are perceived to view innovation. The team conducted research by meeting with outside groups and holding focus groups with OCC staff and developed a definition of Responsible Innovation and eight principles to guide the development of the OCC's framework. A white paper was released for comment and the OCC announced that that it would hold a public forum for stakeholders to discuss their ideas.

The white paper included a definition of Responsible Innovation and the eight principles. The definition is "The use of new or improved financial products, services or processes to meet the evolving needs of consumers, businesses and communities in a manner consistent with sound risk management practices and that aligns with the bank's overall strategy." The eight principles include that the OCC:

- Support Responsible Innovation – there should be an office or point of contact for inquiries and to ensure consistent responses
- Foster a culture of innovation by providing resources to staff
- Encourage responsible innovation that provides fair access to financial services and fair treatment of consumers
- Further safe and sound operations through effective risk management and Encourage banks of all sizes to integrate responsible innovation into their strategic planning

The members of the committee described products that they have considered offering or that they have discussed as part of the strategic planning process. Ms. Knickerbocker clarified that not every innovation involves technology. Comptroller Curry reminded the committee members that it is important to focus on customer's needs when thinking about innovative products. Mr. Bland mentioned the importance of third parties in this context and ensuring that risk management processes are in place.

Member Roundtable

Each of the committee members shared thoughts on issues faced by mutual institutions and community banks in general. Common themes included the following:

- Strategic planning
- Corporate Governance
- Status of the mutual institution segment of the industry
- Shift in customers' expectations
- Capital concerns for mutual institutions
- Succession Planning
- Risk appetite and enterprise risk management
- Accounting issues and implementation of CECL
- Fintech and financial innovation
- Pressure of compliance in the current environment
- Examination consistency

Mutual Forum Discussion and Committee Planning

Charlotte Bahin, Senior Advisor for Thrift Supervision, briefly described the agenda for the OCC/FDIC Joint Mutual Forum was held on August 4. She then asked the committee members to let her know what topics they would like to have discussed at future meetings.

Public Statements, Wrap up and Adjournment

A member of the public said that he urges the OCC to promote mutual institutions and mutuality and to support the development of mutual capital certificates. Another member of the public thanks the OCC and Comptroller Curry for the support of HR 1660.

Mr. Brickman adjourned the meeting at 2:35 p.m.

Certification

/s/ Michael R. Brickman

Michael R. Brickman
Designated Federal Officer