Office of the Comptroller of the Currency
Minutes of the Meeting of the
Mutual Savings Association Advisory Committee
October 3, 2023

The Mutual Savings Association Advisory Committee (MSAAC) was convened for a virtual meeting at 8:30 a.m. on October 3, 2023.

In accordance with the provisions of the Federal Advisory Committee Act (Public Law 92-463), the meeting was open to the public from 8:30 a.m. to 2:30 p.m.

Advisory Committee Members Present

Peter Abt, David Barksdale, Paul Gilbody, George Hermann, Thomas Newbern, David Reynolds, Steven Sloup, Brian Smith and Samuel Wilkinson

OCC Staff Attending

Acting Comptroller of the Currency Michael Hsu, Maria Adams, Jason Almonte, Charlotte Bahin, Julie Blake, Michael Brickman, Beverly Cole, Christopher Crawford, Anna Fee, James Gallagher, Daniel Grantham, John Harootunian, Allison Hester-Haddad, Cristina Im, Anne Kerttula, André King, Ernie Knott, Mariya Komartsova, Crystal Maddox, Paul Moloney, YooJin Na, Erica Onsager, Margot Schwadron, Joe Smith, Demetria Springs, Troy Thornton

Public Meeting
Introduction and General Remarks

Michael Brickman, Deputy Comptroller for Specialty Supervision and Designated Federal Officer of the OCC's Mutual Savings Association Advisory Committee welcomed the members of the Advisory Committee and introduced the OCC staff persons in the room. He gave a brief introduction to the meeting and welcomed Daniel Grantham, Senior Financial Economist, in the Banking and Condition group at the OCC for the economic update.

Economic Update

Mr. Grantham introduced the presentation by saying he would talk about two main areas, what is happening with inflation, and then also a focus on home prices and residential real estate. (The presentation is posted on the MSAAC page on OCC.gov.) He said that he knows that many of the Advisory Committee members have concentrations in residential lending, and he will provide a focus on home prices, where they are going and where they have been. He turned to slide 3 and said that the economy is growing near its post great financial crisis trend. The broadest measure for economic growth and health is real GDP. The chart on the left of the slide looks at the most recent quarters, and the growth rate is slowing down a bit. The growth forecast has been revised down from the initial estimate, but at 2.1 percent is relatively healthy.
He said that consumption is one of the different components that contributes to GDP growth, and it continues to be robust. At least in the most recent quarter, investment return provided a benefit

to GDP. The chart on the right of the slide looks at the level of real GDP over the last eight years and provides a forecast for what it could in the next 18 months. Looking the blue-chip consensus, which is the 50 professional business economists, provides the most optimistic, pessimistic, and the consensus forecast, which is simply the average.

The optimistic group anticipates continued trend growth, with no recession over the next 18 months. The more pessimistic forecasters are predicting a fairly mild recession beginning in a quarter or two. He noted that it is unusual to have so much dispersion between the top and the bottom end of the blue-chip consensus. He said that it may reflect the uncertainty, particularly in the data based on surveys. The survey response rates have not been as good as they were before the pandemic.

On slide four, he noted that, one of the factors that has helped support the economy has been the growth in personal income. There has been a lot of talk about incomes, particularly when adjusted for inflation. Depending on the data source, personal income could be anywhere from real incomes are falling to real incomes are rising. Real income is adjusted for inflation. Personal income takes out government transfers, for example the large stimulus and gives more of an idea of what is more fundamental or more likely to occur. But there has been a dramatic growth in nominal personal income and most of this is inflation. If inflation is stripped away, real incomes are about six percent higher today than they were before the pandemic. Personal consumption spending has grown dramatically as well and is about ten percent higher. Consumption is growing faster than income.

He said that households are still saving, but at a lower rate. Consumers are not digging into their savings, but they are saving a lower amount. The takeaway is that the discrepancy between nominal and real inflation has been an issue for the economy. Before 2020, inflation was relatively stable with a much smaller difference between nominal and real changes. Slide five shows the two main measures for inflation in the economy. One is the consumer price index, and the other is the personal consumption expenditures. This slide looks at the CPI, and it gets the most press coverage. The black line with the circles represents the headline level and it has come down dramatically from nine percent to a little over three percent.

Shelter is the contributing factor to the rising prices right now. The prices of goods have contracted, although over the near term given the auto shutdown, used car prices may go up, which could impact the CPI. Over the last couple months, what has been driving the CPI has been shelter, market rents are a proxy for where price of shelter is going over the near term. Mr. Grantham said that market rents tend to be about four quarters ahead, as reported in CoStar, which uses primarily apartment data. The CPI takes about six to 12 months to catch up to what is going on in the market. On a going forward basis, the expectation is that CPI shelter costs would decline, or more appropriately grow less quickly over the next four quarters. Measuring rent is incredibly difficult. He asked the Advisory Committee members what they are seeing in their local economies. He asked whether rent growth has slowed.

An Advisory Committee member said that people are moving into the community at a higher rate than before, and there is a shortage that has to catch up. Mr. Grantham asked whether Advisory Committee members are seeing any easing in rent or whether it is increasing, but at a smaller rate, in areas that are losing population, for example Louisiana has reported a loss in population. He said that the Fed has been focusing on what is left that is causing inflation, and that is all services excluding shelter within the CPI. Slide six shows a cooling labor market. In economics the focus is both on levels and directions, so the labor market is cool, but it remains incredibly tight. Mr. Grantham said one of the favorite measures for former Fed Chairwoman Yellen was the "quits" rate. That is people voluntarily deciding to quit their jobs, her rationale was it was a measure of confidence in the economy that a person would quit their job and not have something else lined up.

He said that the "quit rates" have declined from all time highs, but the chart on the left shows the most recent observation, the "quit rate" is still higher than it was anytime before covid. The reason people focus on this, particularly in this cycle, is the huge degree of difference between wage growth for job stayers and job switchers. On the chart on the right, job switchers have a much higher wage growth than people that are electing to stay in their positions. He said that it is not surprising, but the level of difference this cycle is somewhat surprising. Wages for job switchers, were up over eight percent and now they are up over six percent. It has dropped a quarter, but still six percent wage growth is still pretty fast. Over the next couple of quarters, this rate will be watched to see where it tracks, because wages at this level are inconsistent with the Fed reaching its two percent target for inflation. As an advanced economy, the biggest cost is wages, it is labor. Mr. Grantham asked whether Advisory Committee members are seeing any amelioration in the local markets for attracting talent and paying them.

An Advisory Committee member said that costs are going up in his small community. He said that when he asks anybody in any line of business, they say they have a tough time finding anybody and the prices just keep going up to try to get them.

An Advisory Committee member said that it has stabilized some in his market. They are still able to find folks. The amount of the increases has stabilized some, but the entry level workers and lower-level workers are really burning through savings. Another Advisory Committee member said that that worker is starting to feel the pinch of inflation.

Mr. Grantham said that in the last month or two he has started to see those that are the lower end deplete some of their checking account balances. An Advisory Committee member said that from the perspective of his institution, they have reached the tipping point where they are investing in automation because at the entry level the bank is competing against companies like Amazon. They can staff from a central location with people, who will be paid more because they need a different skillset. He said that he does not know whether it will affect labor costs, but the efficiency and ability to serve customers will be better once they get on board. Amazon is building huge facilities in the area, and his bank cannot get entry level employees. There is a big push on workforce development right now to try to develop skilled people to come in and take the jobs and to move people out of the entry level into more of a skilled situation.

Mr. Grantham asked whether attracting skilled labor is any easier. An Advisory Committee member said that employers steal from their friends. However, since the pandemic there are certain skilled positions where employees can work one hundred percent remotely. It does not matter if a credit analyst is in the other part of the state or several states away. It is the same with mortgage processors. That has been a huge cultural shift within the organization. There is a lot of competition in the market. Where the bank is has difficulty is finding skilled enough people that can provide the service the bank is looking for that want to do that job. That is at the branch level. There is still a lot of competition out there for the jobs.

An Advisory Committee member said that one of the things that has helped in the midst of this, and it started with the pandemic is that the workforce is more nimble than it was before. Employees were cross-trained in ways as never before. Banks were willing to adjust where people are and reposition to create the most efficiency in any given day or week.

An Advisory Committee member said they have very loyal employees, but they get offers every single day for a good bit more money than the bank can pay, but they stay out of loyalty. He said that they have tellers that retire after 40 years. The job market is tight now. There is a supply and demand problem in housing. As people move into the community, they build new homes and skilled laborers in the market are through the roof.

Mr. Grantham asked whether the labor market in the banks' areas is tighter today than it was six months ago. Is there some cooling. An Advisory Committee said that he sees the bank has loyal employees in the 30 to 35 and up age bracket. The younger employees coming in tellers are gone in nine months or 12 months. It did not used to be that way. Employees would start as a teller, and they would stay and move through the ranks.

An Advisory Committee member said that he finds the bank has a more nimble management. As they look at skilled positions, if an employee leaves, they do not necessarily replace the job in the same manner, but they look at how it can be enhanced with technology or other factors. But it makes the management team work and look forward more to where it wants to be as the bank grows. For example, when the bank is approaching a billion dollars, but you have a half a billion dollar skill set person, the bank has to hire the billion to 1.5 billion skillset person. He said that even in the executive management, the bank looks at things that way. It is how the business evolves.

An Advisory Committee member said he is interested to hear from others whether they have benefited from the consolidation of other banks. He said that he has hired employees from regional banks and smaller community banks that have sold and consolidated in his area. Large banks do not have loan processers in the community. They are all in larger cities. He said that his bank has hired skilled staff. He said that because to train employees from start as a credit analyst for mortgages is not an easy thing for a small bank. When the bank is able to pull an employee from a bank that has consolidated or sold to another institution, it is beneficial.

An Advisory Committee member said that they did that until the larger banks all went away. Another Advisory Committee member said that his similar experience was not on the support side but more the on the sales side.
Mr. Grantham said that slide seven shows the linkage between labor costs and tightness in the labor market. He said that it is harder to attract talent and banks may have to pay more. There is a direct correlation between labor costs and the CPI for services. As the labor market cools, maybe

wages will come down or ameliorate and inflation may return to the Fed target of two percent. But without substantial cooling in the labor market, it is difficult to see getting there.

Slide eight shows that in the 1980's the Fed funds rate was well in excess of the inflation rate this cycle. Only recently has the Fed funds rate gotten close to the level of inflation and there has not been any movement in the unemployment rate. The labor market this time has started to cool primarily through fewer job openings as opposed to unemployment. It is a different scenario than in the 1980s and late seventies. It calls into question where the trajectory for inflation is going forward. What is the appropriate level for monetary policy given some of the uniqueness for this cycle.

An Advisory Committee member asked whether the Phillips curve still valid. Mr. Grantham said that if the Phillips curve were mapped it would be the relationship between inflation and unemployment on a dot plot and the hope would be a straight line for correlation. A lot the Fed models are still built around the idea of the Phillips curve. Slide 11, shows one of the challenges of this cycle has been that the economy has been resilient in interest rates because there is more fixed-rate debt outstanding. On both the household side, about 89 percent of all outstanding consumer credit is fixed-rate. Consumers have locked in low-rate mortgages and auto rates. Credit card rates are floating. If an 18 percent interest rate becomes a 24 percent rate, it is a bad rate to a bad rate. There is more insulation this cycle because consumers locked in low rates even on the corporate side. On the chart on the right on the slide, business expense as a share of earnings before interest in taxes, is a lot lower than it has been over the last 50 years. A lot of the larger corporates locked in low fixed rates for longer terms. The cash they are holding, which is substantial, is earning a higher yield. In this cycle, the economy is a lot more insulated from higher rates, which is making the Fed's job more difficult than it had been particularly prior to 2008.

An Advisory Committee member asked if everybody is locking in low rates, when will it settle. Because corporate debt is going to start repricing and it will absolutely squelch the housing market because there was a zero-interest rate policy for so long that young folks in particular cannot afford to buy houses. Applications for home mortgages layered on top of interest rates shows a correlation as rates have skyrocketed, housing applications have gone through the floor. Refinancing is dead.

Mr. Grantham said that the residential section on slide 13 shows something that is really interesting. The housing market in general started to cool off in terms of prices in the fall of 2022 when the Fed started raising rates. Prices have rebounded and one of the fundamental reasons prices rebounded despite housing being at very unaffordable levels, particularly, for starter homes is because the lack of supply. Slide 17 shows there are two main issues for supply. There are not enough homes outstanding in the US overall.

He said that the homeowner vacancy rate is on the left on the slide, the vacancy rate is at an all time low going back 70 years. Fewer homes have been built than households have been formed. The share of homes for sale, both new and existing as a share of a total stock is also at a 40-year low. People are not putting their homes up for sale, to the same degree because of the lock-in effect. If a homeowner has a three percent mortgage rate and the current rate is seven or eight percent, they are much less likely to sell their house.

Mr. Grantham said that slide 18 shows that for all outstanding mortgages in the US, 80 percent have an interest rate below five percent, 23 percent have an interest rate below three percent. from a historical perspective, in the eighties shown on the chart on the left, the red line would be the current rate that is available in the market. Home buyers were paying an 18 percent interest rate on a 30- year fixed loan.

He said that in 1982, the effective rate for all mortgages at that time was a little under 11 percent. The spread in the eighties was worse than it is today, and if the ratio of new and existing homes sold is compared to the housing stock, it was actually lower then than it is today. There is a definitive correlation going back in time for other periods where the prevailing rate was much higher than what people currently had. One of the challenges here is that all the indices of home prices are repeat sales. One house that sold is tracked it over time. It sells again.

Mr. Grantham turned to slide 15 to look at home prices from December 19 to the most recent date of July of this year, the lowest metro had a nice percent growth rate. That was Odessa, Texas. But the US average is a 46 percent increase in home prices. In the south, there has been a huge increase in population of people moving down there. There is a lot of additional home equity this cycle. When low fixed rates are layered in and a lot of people have locked in there is a large disincentive for anyone to put their home on the market or to move, which is supporting home prices quite dramatically.

He said he is looking at whether there is a regional disparity in terms of outstanding mortgage rates. Slide 19 shows the largest 380 metro areas and the share of loans outstanding in these metros that have an interest rate below five percent. The regional differences are quite staggering. In San Francisco more than 87 percent of those mortgages have a rate below five percent. In other areas, Texas and much of the south, there are lower interest rates. He said that this suggests that there is more availability or more possibility for homes to come on the market because there is less of a lock-in effect. It is still significant, but it is less significant than some of the other areas particularly on the West coast.

An Advisory Committee member asked whether the lure of the metro as being a factor for housing activity. He said that he does not think that consumers are moving up houses or down houses within a city because of the lock-in effect. Nobody is going to sell their house and move across the street and trade a three percent mortgage for a seven percent mortgage. However, if consumers move to a new city unless they going to have a big commute, they have to buy or sell a house.

Mr. Grantham said he is trying to draw linkages. North Carolina has building regulations and available land are a lot different than other metros. He has looked at whether there is more likely to be homes built in North Carolina to respond to the increase in population growth, compared to what is on the West coast, where building regulations are a lot tighter, land is a lot more expensive. There is less of an increase in homes being built. He tries to layer in and look at population growth in some areas, how is the home market for builders responding and is the residential real estate investment in the US overall starting to rebound. Traditionally that is one of the main mechanisms. The Fed pounds on rates, makes it less economically viable to build houses. But when there is a huge shortage, the rates are negated. He said he is curious to hear from the Advisory Committee members whether they are seeing an uptick in building to respond to the structural shortages or are builders scared by the rates.

An Advisory Committee member said that in one of his markets there is a phenomenal amount of activity. Another Advisory Committee member also sees a lot of activity. Another Advisory Committee member said that there is construction both from national groups and local builders, but land development is lagging, but it is pent up demand. The local builders are adding houses. There is plenty of land to build.

An Advisory Committee member said that in his market, they have seen a lot of growth from people moving from Florida as well as from New York and LA. There has been a house shortage and people are not typically as worried about rates. The bank's portfolio is in an adjustable-rate product. He said they price the adjustable-rate product at or around the secondary market fixed rate. There is a lot of competition for loans the area, but he said that the bank is only one that holds their mortgage loans in portfolio. Consumers find a lot of value in that.

An Advisory Committee member said that in his area supply and demand is more important than the interest rate in the environment just because of the dearth of new construction. At the high end there are so many cash buyers that interest rates really have not impacted sales. The prices are about $2 million and above. They have affected new housing starts in larger subdivisions. There are not very many starter homes, but there is multi-family. Consumers who want to buy are limited. The further out from major metro areas, there are more options, but fewer subdivisions are being started because that they are more impacted by interest rates.

The Advisory Committee member said that supply and demand is counterbalancing the interest rates that to the point where they have not seen the effect. He said that the longer they go out in duration, the more it will impact it if supply and demand catches up. For now, it does not seem to be affecting the sales side as much as it is on the build side. He said that land is expensive, but the contractors do not want to get out ahead because of inflation.

He said it is a real challenge. There are not any younger people that want to be home builders. There a big players but the smaller ones are an aging graying group of people that are building and developing at this point. Mr. Grantham said that what he had heard before the pandemic was labor shortages were a huge issue for builders being able to deliver. There has been an increase in the number of home or construction employment. He asked whether labor is cited as an issue for delivering. He also asked whether the Advisory Committee members were involved in multi-family lending and whether there is growth in that market.

An Advisory Committee member said that his market has lots of multifamily going on, his bank specifically does not do a lot with except lower income multifamily. But it a hot topic in the area as it needs more multifamily because more people are moving in. Towns that have been reticent in the past to approve some of these multifamily structures are more likely to do so. The demand is so high, and the supply is so low.

An Advisory Committee member said that there is a really a big need in his area, and it is not catching up. There is a lot of building going on. The construction is being financed. It is a very competitive market, especially for the loans at the end of the construction. The loans automatically reprice, but they seemed to have been able to weather the storm because of the increase in the rents.

He said that they are concerned about absorption. Everything continues to be leased up, but it can not go on forever at this point. The bank is cautious on that side. An Advisory Committee member said that his bank has had some large projects that have been low- to moderate-income type government type programs. The absorption rate is phenomenal, but the bank are also in a market where one contractor sees another contractor make a pretty big profit on an apartment building and everybody wants to build an apartment building. He said they very careful with multifamily.

Mr. Grantham turned to slide 20 to show where economists see home prices going nationally. The chart shows mortgage rates are nearing 20-year highs depending on the series, but it is really the lack of inventory for sale. There is a lack of homes for sale that are really putting a floor on home prices. Slide 21 shows a varied forecast for where some of the larger lenders see home prices going. He said that most of them show them slowing down or declining slightly. But even the most pessimistic forecast currently, which is from Fannie Mae, only shows prices declining nationally now six percent, which would be equivalent to the first quarter of 2022.

He said that he wanted to survey the members in terms of where they see consumer health. Jobs are available fairly robustly. Wages are growing, but from the outset, at least when inflation was taking off, there was concern about consumers getting squeezed and running down their savings. There was a large amount of stimulus that supported the consumer. An Advisory Committee member said that in his area he is starting to see a squeeze, nothing major, but the number of slow pays, 30 days past due, are increasing. Part of that is just not having the savings and all of a sudden, the consumer has to pay real estate taxes and they look at what they paid for the house, and they realize they did int think about it all.

Mr. Grantham asked whether in the payment hierarchy, are the members seeing any changes. He asked whether consumers are electing not to pay or are they just starting to see delinquencies. Several Advisory Committee members said they have to make more phone calls to get consumers to make the payments. Delinquencies are still at record lows, but a really cold winter in the Northeast with high heating prices could be a potential tipping point with people. There have been problems with electric rates. That will put pressure on consumers.

An Advisory Committee member said that he reads that it is doom and gloom, but he not seeing it. His delinquencies are still very low. People are still buying cars that are a hundred thousand dollars for a Chevrolet pickup truck or dodge truck. His bank has raised rates to where they think they are appropriate, and they still have demand. He has slowed down on purpose because of his own thinking that things are coming so be careful. But the truth of the matter is, they have not seen the consumer change, and quit buying anything yet. Business commercial delinquencies are very low, and the bank is throwing out higher and higher rates. His bank is probably a little unique, there is not a lot of large bank competition in the town.

Another Advisory Committee member said that he is seeing the same thing. He sees the end is near though. He says he has a lot of competition, but it is mainly secondary market type activity. Another Advisory Committee member said that in his area, delinquencies have been improving for at least two to three years and probably are at an all-time high right now. So, the local economy's strong, and consumers are strong.

Mr. Grantham described the conclusions on slide 22 and thanked the Advisory Members for their questions.

Mortgage Update

Mr. Brickman introduced Joe Smith, Technical Expert, Mortgage Banking Risk, in the OCC Credit Risk area of Bank Supervision Policy. Mr. Smith had sent questions to the Advisory Committee members in advance of the meeting. A copy of the questions is attached as Appendix A.

Mr. Smith explained that what risks he looks at in the mortgage lending and banking area. He told the Advisory Committee members that they have headline risk and managing that headline risk is diving deeply into the understanding of the issues that are driving performance, driving the demand. He said they would look at what to expect as they think about moving forward. He said as risk management officers questions about capital, underwriting standards, and originating and processing loans are part of the discussion.

He said that he wanted to discuss two issues about the Advisory Committee member's markets and what they are seeing. One question what is going on in the world of products to get more consumers to originate loans. The second question he asked is about some the details around the processing of loans. He asked whether reducing the amount of documentation that the GSEs require is a positive development.

He said that another big market influencing factor is non-depository financial institutions and note that non-depository financial institutions today consummate 82 to 85 percent of originations on a monthly basis. He mentioned some of the competitive issues that the Advisory Committee members had talked about.

Mr. Smith said that when he started as a loan officer, the mantra was to get the borrower off the street, get them to the closing table as quickly as possible. In order to do that lenders have to have faster processing times so they adjust the processing and adjust the documentation, but means adjusting the risk management.

He said that mortgage delinquencies are at approximately 3.17 percent to 3.3 percent now. The expectation is that they will get worse and that is not because of the credit in the portfolios, but because of macro scenarios that may have an impact. There is a minor uptick in the delinquencies of credit cards. Mr. Smith said he would like to look at the affect of the pandemic on the market and the business.

Mr. Smith asked the Advisory Committee members to give a flavor of their markets, their pressures, and then to think about some of the product features that they say are causing pressure and some of the processing elements.

An Advisory Committee member said that volumes are down. He said the real demand seems to be construction perms and refis, he said they are only divorce refis right now. He said the bank is having a hard time with giving the mortgage originators enough business to keep them at least employed. He said they have made some changes to try to adjust. For example, they looked at the products they offer that work in the marketplace. He said that one piece is the construction perm loan. He compared the rates to the deposit rates. His retail staff say the bank need at least one or two CD specials to keep consumers from going to a competitor. He said that they have a mortgage product for construction perm. Some credit unions have a lower rate product but the rate helps the bank keep customers.

An Advisory Committee member said that he has seen a decrease in the bank's mortgage lending, and they do not have a lot in the pipeline. He has noticed that it is rate driven. The rates are relatively, but a lot of consumers are first time home buyers and are used to seeing the two to three percent. When the rate goes up, they are a little bit shy to jump in there. He said that he has heard that a lot of the lending is not the competition across the street, but Rocket mortgage or an online banking company that does not have brick and mortar offices in the market or anywhere within the bank's our footprint.

An Advisory Committee member said that his bank is a 120-year old institution and they keep all mortgage loans on the books. The bank has never sold a loan in 120 years. They started commercial lending four years ago, and now have 25 percent of the portfolio in commercial, and 75 percent the mortgage space. The bank's volume this year may hit 30 percent of what it was during the refinance boom. The mortgage bankers are all on salary, and so that kind of good news, bad news. They have not left for other banks, but they have moved in the bank, and the bank will not backfill the positions. One is going into a quality control because in 2024, the bank we will begin to sell mortgages on the secondary market. The model the bank has used for 120 years of booking mortgages and putting them on the books is not sustainable. The bank is going through a fairly significant shift in its business model looks and shifting more emphasis toward the commercial side, and then selling mortgages on the secondary market. Younger customers will get their mortgages very differently, they will do it with a click of a button sitting in a cafe somewhere. The Advisory Committee member said that he is not sure the business is coming back and if the bank does not change, it may be irrelevant.

An Advisory Committee member said that his bank is at about 25 percent of the originations from the past two years. He said his observation is that there are two distinct lender workforces. Those that have been employed by lenders strongly aligned with GSEs and those that are not. He said that his experience in making progress and becoming more aggressive and creative is that that is all they know is GSE lending. He said they have found that the process of change is very difficult for those folks. He said the bank does not get the candidates that have not worked with the GSEs and it is hard to be progressive and competitive.

Mr. Smith asked what type of product development the bank has used to try to be creative. The Advisory Committee member said that they have tried some of the professional doctor or lawyer streamlined underwriting. They put a product together. He said they tried a CRA focused low to moderate income loans. The bank set aside a pool of funds to make zero down payment loans with competitive interest rates. They are putting some of those programs together now, but the, the reality is the business is just, it is in a coma,

An Advisory Committee member said that the bank was formed in 1934 and it has never sold a loan either and it has always had the same type of business strategy. He said they tried to bring in the products and services that commercial bank counterparts offer. He said that Covid created an impersonal society or the age of technologies created an impersonal society. He said they have enough people within the organization and young people that are in touch with realtors, builders and others that send their clients to the bank because of who it is.

Mr. Smith said that banks are taking credit risk, liquidity risk, and interest rate risk when they retain loans on the books, but they are not getting paid for it because the bank offers a similar rate as nonbank competitor. An Advisory Committee member said that one of the biggest competitors banks have been the credit bureaus. When a bank pulls up a mortgage credit the consumer gets a hundred calls from a hundred different other lenders trying to get them to do the loan with them. An Advisory Committee said that especially when the bank is the community option for the person, and they get phone calls from all over the country. The banks explain it to the consumers but the bank cannot stop it from happening.

An Advisory Committee member said that unlike several of the members, his bank has sold loans in the secondary market for a long time. It takes a lot more staffing to service the loans and get them packaged to sell. He said that his bank is hesitant to reduce that staffing right now because volume is so low. He remembers that if rates come down just a little bit some borrowers start refinancing and the bank will need staff who are expert to help right away with the processing. He said that the bank is biding time and have increased the loans that retain the servicing.

He said that he is concerned about raising the debt-to-income ratio allowance and changing LTVs for less than qualified borrowers. He said that selling to the GSEs has helped with volume, but he is worried about some of the approvals. Mr. Smith said that generationally there are different perspectives of risk, and it is evident at the OCC, some of the younger examiners expect that two or three percent is a normal rate. He said that FHA does a lot to try and help first time home buyers. As a matter of fact, 87 percent of their volume is first time home buyer product. Systemically debt-to-income ratios have been adjusted. And this goes to the whole two points about risk. One product features two processes. That is better, faster, quicker to get the borrower to the tape. From a smaller bank perspective, banks serve valuable service to the community. Banks provide them that touch, that education that is needed. But the risk on the other side is something that is paid attention to.

Now there is one debt to income ratio with no cash reserve requirements. And that is the same with agency paper too. Fannie Mae, Freddie Mac, a borrower does not need six months reserves. So, what does it mean systemically. He said that he thinks that what the members do in terms of monitoring their communities and providing that service is invaluable. An Advisory Committee said that his bank is primarily commercial. About 25 percent of the book is residential at this point. Over the last several years, most of the residential was first time home buyers because competing against the non-bank lenders the bank was able to provide the service. There are no first-time home buyers in the market right now.

He said that several years ago, the bank outsourced the whole program. Unfortunately, that company went out of business however the way that they unwound it was very financially advantageous to the bank. He said they hired several of their staff who actually came to work for the bank. They are not local. It has allowed the bank to continue with that but it is not a big part of the growth long term. He recognized that the bank could not compete at the level years ago, and they made the commitment to commercial.

An Advisory Committee member said that the bank has had problems with business in 2023 that the bank did not anticipate. He said that they get the majority of our business from referrals from builders and realtors. Most of the products are adjustable rates. The bank retains servicing rights and sells loans into the secondary market to the Federal Home Loan Bank.

Mr. Smith said that FHA was making loans with 97 to 100 percent LTVs with 45percent debt to income ratios. The agency backed away from those loans because they found out very quickly that that the loans did not perform to their expectations. He said that he does not want to see anybody fail, but he thinks that there will probably be an adjustment. The goal is to try and get people into homes, but in homes that they are able to afford.

He said that the responsibility that the agency bears is extremely important. As this credit conversation concludes, a point came up several times in at different places about technology, machine learning, AI, and its impact on the process. He said he is interested in how technology is currently being used by banks. He is also interested in whether the members see machine learning and AI as the same and what is the cost. If the technology is for internal uses, it is an expensive machine. That is why a lot of lenders use DU and LP with the GSEs for delivery when they sell into the secondary market. It gives automatic decisioning. A lender can have a tie into the machine and go from there.

An Advisory Committee member said that he does not use AI at all. He said he is technology challenged. Mr. Smith asked what the greatest concern is. The Advisory Committee member said that he is worried about retaining the current business and the ensuring the approval process is accurately assessing consumers.

An Advisory Committee member said that his bank is using technology some and have added it in to products the bank uses primarily on the commercial side of the business. Staff uses technology for mundane tasks because it makes it a more efficient process. He said that his bank does not use any type of automated underwriting. They use it to enhance processes at this point.

Another Advisory Committee member said that on the commercial side his bank also uses automation for activities like scanning and tax returns. His bank does not take recommendations for underwriting. But on the residential side, the bank uses LP, but they do not know enough about AI and do not use it.

Mr. Smith said that the element element of machine learning and AI that concerns everyone is fraud. Using the technology to duplicate information for fraudulent purposes is something that everyone has to pay attention to for the benefit of the system as a whole.

An Advisory Committee member said that his reaction is that he is afraid of it, but he embraces it if it makes sense. He said that he does not know if a community bank survives in the AI world. He said that we do not understand the long-term effects of what AI could do. He had heard that some companies think that AI will take over the banking business.

An Advisory Committee member said that the most immediate reality of AI for him is definitely all things security. The reality today is that AI presents security risks that banks need to get out in front of. He said that other than that, the only area that his bank is actively looking at using it for is underwriting models to see what they can do and if they can be cost effective. He said that his bank is staring to look at it, but he is curious to see what impact it has is in the area of ALCO because he expects that it is going to advance ALCO models and the type of analysis that banks are able to do in the asset liability management area.

An Advisory Committee member said that his banks does not use it, but he knows it is coming. He said that looking at the early days of the internet, there were many of the same security risks and fraud but now it is part of life. He said that blockchain was a way to move illegal money, but it is here now and is going to continue to grow. He thinks that the use of AI will grow, and banks will be dependent on it.

An Advisory Committee member said that he agrees with many of the comments and that he looks at AI from the security standpoint, and it is scary but there are also some things that it could be very beneficial for the industry. As community banks. The personal touch will always be important. AI may assist with some of that, but it will not eliminate it. He said that is an advantage for community banks. He said that he fears that AI replaces relationships.

An Advisory Committee member said there are other places that his bank is using AI right now. He said that sometimes people are thinking about chat GTP as opposed to AI. AI is very helpful in the BSA/AML area because it allows the bank to connect dots that staff will not necessarily connect and highlight things. It is not replacing that process, but it is able to go through and help with connections. The same thing on the IT side with using artificial intelligence to scan logs, there are so many logs that AI can potentially connect some dots that somebody individually looking at these things would not. His bank uses AI to enhance current processes especially in the fraud area.

Mr. Smith said that AI can be used to draw specific correlations to credit characteristics that give banks on an individual loan basis, not a pool basis, an individual loan basis, the ability to understand probabilities of default with a greater acuity. From the processing perspective, the personal connection is important, and AI is a tool.

He asked how much will banks let that tool further commoditize the nature of the residential lending market and or, and the commercial market. In the past credit scores were not even used in underwriting residential loans. Alternative documentation was used. He said that he hopes that banks have that type of discipline as a system to maintain a level of understanding of those finer points, to be able to come up with meaningful credit decisions, to have that personal contact and to still be able to do that community outreach and education, because that could be in jeopardy with machine learning or AI.

Mr. Smith concluded by thanking the Advisory Committee members for their comments.

Mutual Financial Trends

Mr. Brickman introduced Ernie Knott, an OCC financial analyst in the Northeast Region. Mr. Knott's presentation of Mutual Financial Trends is posted on OCC.gov.

Mr. Knott explained the sections of his presentation and the agenda. Slide 3 shows information about the OCC portfolio of banks. He pointed out that mutuals represent nine percent of total OCC charters. Slide 4 shows the trends in the numbers of federal savings associations, both stock and mutual from 2011 to the present. He said that consolidation continues in the banking industry for both state and national charters. At year end, there were 253 FSAs. He pointed out that at year end 2011 the mutual differential was 200. There were 211 more stock FSAs at that time. That differential now is 51. The bottom line is that while mutual FSAs continue to decline, they are not declining as rapidly as stock FSAs.

On slide 5, he noted that 31 percent of mutuals had under a hundred million in assets and eight percent have over a billion in assets. He said that for this slide, the definition of a mutual includes mutual holding companies that have not issued stock. With those additions, 51 percent of the FSA population is mutual. He pointed out that 36 or 14 percent of FSA charters have elected to operate as covered savings associations. The map on slide 7 also includes mutual holding companies that have not issued stock, but the rest of the slides will only include pure mutuals.

Slide 8 shows the lender peer groups. Ninety one percent of mutual FSAs are residential real estate lenders. The slide also shows that 58 percent of mutuals operate from three locations or less. Slide 9 shows supervisory ratings and specialty ratings. Mr. Knott said that for the OCC mutual population, composite ratings are satisfactory.

Slide 10 shows the top three risks for mutuals. The top risk for mutuals is interest rate risk followed by strategic risk and operational risk. Interest rate risk is the only risk of those top three that is increasing. Slide 11 shows matters requiring attention and violations of law. MRAs are where examiners communicate concerns about a bank's deficient practices. Commercial credit saw the largest increase and bank information technology saw the largest decrease for the year. The individual categories of commercial credit include underwriting concentrations, allowance, and credit administration. Violations of law are down 16 percent. The top three violations cited are Truth in lending, Real Estate Lending and Appraisals and Bank Secrecy Act.

The financial performance information starts with slide 12. Mutual capital ratios remain strong and above peer. Mr. Knott pointed out that the gap in the capital levels of OCC and FDIC supervised mutuals have widened since 2021. He said that smaller mutuals generally have higher capital levels. Slide 13 shows that mutuals are well capitalized and hundred percent of them are well capitalized for prompt corrective action purposes. Slide 14 shows asset quality. Asset quality ratings continue to improve. Ninety eight percent of mutuals are rated one or two and delinquencies are low and continue to decline. Slide 15 shows that median loan growth improved 8.16 percent. There are 11 mutuals that reported an aggregate of $675,000 PPP loans. Commercial real estate is growing more than other portfolio categories.

Slide 16 shows earnings ratings and Mr. Knott said that in general earnings lag ratings in other safety and soundness areas for mutuals and all groups of institutions, however 82 percent of mutuals are rated one or two. Slide 17 shows that net income has increased despite higher overhead and contraction in fee income, due to strong growth in the net interest income.

Slide 18 shows that after four quarters of expansion, new interest margin has contracted this quarter, and this was due to the large jump in the cost of funds. Mr. Knott said this an important change, the cost of funds went up by more 13 basis points and the weighted average margin contracted four basis points to 2.87 from 2.91.

Slide 20 show liquidity ratings. He said that liquidity is the main story right now. Liquidity ratings remain strong, but there has been a decline in deposits. They decreased 1.67 percent for the quarter, 1.3 percent year to date, and 2.9 percent from a year ago. Slide 21 shows lower on-hand liquidity, and because of that reliance on wholesale funding has increased. Slide 22 shows that the cost of deposits rose sharply, but looking at the balance sheet, deposits are a little lower versus pre pandemic. Other borrowings and Federal Home loan Bank advances have increased. Mr. Knott said to look at the change to the deposit mix.

Slide 23 shows that sensitivity is adequately controlled. Investment depreciation is a ratio that looks at both health and maturity and available for sale, total depreciation. Due to the rise in rates and extended maturities, the depreciation remained significant. Slide 26 shows the dot plot, which is released quarterly in March, June, September, and December.

Mr. Brickman explained that Mr. Knott produces specialized reports for the mutual industry. he let the Advisory Committee members know that if they have not reached out and gotten the Q books or other tools from him, just let him know.

Capital Policy Update

Mr. Brickman introduced Margot Schwadron the OCC's Director of Capital Policy in the Bank Supervision Policy line of business. He said that she would provide a capital update and then answer any questions the members have on any hot topics in the capital area. Ms. Schwadron said that she would provide a high-level summary of the proposals the agencies have issued. She said they have been in the press and Congress is very interested in them. She said that the first thing she wanted to emphasize is that the proposals will not apply to any of the members of the

Advisory Committee. They are intended to apply to the large banking organizations and by large banking organization, the definition is a bank that is over a hundred billion dollars of total assets. In July, the agencies published a proposal to amend the capital framework for large banking organizations and for banks with significant trading activity, which is defined as having more than $5 billion of trading assets or trading liabilities or 10 percent of a bank's assets are in trading.

She said the proposal is intended to strengthen the calculation of risk-based capital requirements to better reflect the risks of these banks, enhance the consistency of requirements across large banks, and facilitate more effective supervisory and market assessments of capital adequacy at these banks. Enhancing the resiliency of US banks will reduce the risks to US financial stability and cost to the FDIC Deposit Insurance Fund. The proposal will replace internal models that these large banks were able to use for estimating capital requirements for credit risk and it will replace them with more risk sensitive standardized approaches. The reforms are consistent with the international capital standards issued by the Basel committee.

In August, the agencies issued a second proposal that would require category two through four banks, which again are the largest banks in the US, to issue minimum amounts of eligible long-term debt. The proposal is designed to ensure that these large banks have sufficient resources to absorb losses in a resolution proceeding, which can improve their resolvability and reduce costs for the Deposit Insurance Fund and would also mitigate contagion and financial stability risks. The goal is that the long-term debt could be used to pay off the uninsured depositors instead of the Deposit Insurance Fund. It will give the FDIC more flexibility in resolving the institution.

She turned to the capital developments applicable to the Advisory Committee members' institutions. Capital that mutuals raise has to meet the eligibility criteria in order to count as regulatory capital. The OCC recognizes that there are unique challenges that mutuals have in raising capital. It cannot be done very quickly and mutuals build capital almost exclusively through retained earnings. Capital planning is very critical for mutual institutions. She reminded the Advisory Committee members that regardless of what something is called or marketed as, such as a share deposit, it still has to meet the criteria for regulatory capital.

The eligibility requirements for an instrument to count as CET1 include that the instrument must be paid in, issued directly by the mutual bank, and represent the most subordinate claim in receivership, insolvency, or liquidation. It must be considered equity under GAAP. For an innovative instrument, the OCC expects that the bank would have an opinion from their auditor saying that this is an equity instrument under GAAP. As it relates to dividends, there are some important things to consider. Dividends must be non-cumulative for CET1 instruments or for additional tier one instruments.

For common equity instruments, there cannot be a stated or expected dividend rate. It has to be up to the full discretion of the board as to how much and when to pay dividends for additional tier one instruments, which are preferred type instruments. There can be a stated dividend rate or formula that is linked to a rate, but the rate cannot change or reset in any way based on the credit quality of the bank. The credit quality of the bank has to be taken into consideration when the rate is set on day one. After that, it cannot be part of the consideration for how much to pay.

A mutual must always have full discretion to refrain from paying any dividends and making any other distributions on the instrument. The agency does recognize that mutual banks may have internal dividend policies. However, it is important that such policy not be communicated to potential investors or be included in any of the offering documents. To qualify for a CET1, the instrument cannot have a maturity date and there can be no expectation that the mutual bank will buy buyback, cancel, or somehow redeem the instrument. It can only be redeemed by discretionary repurchases with prior regulatory approval.

She said that it seems like a big hurdle to get to a common equity tier one instrument that would meet all these criteria. She said that Walden Mutual Bank was able to do that. The FDIC considered the special deposits common equity tier one instruments. The special deposit shares were not FDIC insured, and that was part of the information released to the investors.

Consistent with all the regulatory constraints around paying dividends, the marketing materials did describe the internal dividend policy. The marketing materials indicated that the bank intended to put a portion of their profits aside and as a reserve to potentially pay dividends. But there was no guarantee for those dividends. In fact, the investors had to sign agreements. OCC staff understands the disclosures saying that they acknowledge that there is no guarantee that their return would be as stated or consistent with the internal dividend policy. She said it is important that common equity tier one instruments are there to absorb losses and so there is no guaranteed return to investors.

An Advisory Committee member asked based on the remarks, whether an instrument that mirrored the Walden instrument be acceptable to the OCC. She said that potentially it would. OCC staff would have to look at all the terms to make sure that it met the eligibility criteria. OCC was consulted by the FDIC when they were evaluating the Walden instrument and the Acting Comptroller as a member of the FDIC board had to sign off on it. She said that the OCC is are open and always available to review specific instruments and the term sheets and work closely with any institution or their advisors, to make sure that it meets the eligibility criteria.

Mr. Brickman said that the OCC has had success in having bankers talk directly with the capital policy team and have them provide feedback once they get to a stage where they are reasonably close to wanting to use a particular instrument. For example, the parameters around actually getting an accountant to review and having like some real kind of weight behind what is submitted to the agency. The OCC is open to providing that feedback, reviewing the terms of the instrument to see if it aligns with the capital standards and providing candid feedback on any instrument that gets developed or suggested. Several charters have inquired in the past and several groups of banks have also approached us. The OCC wants to be able to provide as quick and reliable feedback as possible on the direction the proposal is heading.

An Advisory Committee member said that they understand the tension between investors wanting a return and the limitations of a CET1 instrument and promising a return. Mr. Brickman said that his experience from the supervision side is that the conversations tend to fall apart once the question is asked about who would buy the product that has been developed. Walden Mutual Bank is a unique example of investors who saw a gap in banking services and were willing to put their money into an entity without kind of that promise or return that would come with some guaranteed payment or dividend or redemption.

An Advisory Committee member said that they had had conversations with community development groups that would be potentially looking to do a grant for affordable housing. If the have group has the funds and they were going to put a million dollars into a grant, the bank could leverage it 10 times with a capital instrument, it would be a win-win for the community.

Mr. Brickman said that said that the OCC has had people approach it about working with a philanthropic group for grant money or other forms of investment that are not true investors in the sense they are not looking for a return in a financial sense, but a return in the investment made in the community. Banks need to find the volume of those people that would be able to recapitalize or capitalize a bank and it is hard to find a large enough group. Most mutuals have not had the need to press for additional capital so there has not been a group that can get that across the finish line. Agency staff would love to continue to engage in those conversations just to have proof positive there are tools available if groups are creative about how to construct them and work with the agency on the technical side of things.

Ms. Schwadron said that the idea does not have to be fully baked. OCC staff is open to questions and will provide advice along the way. An Advisory Committee member said that it is helpful to know that because it is a chicken and egg situation. The question is who will buy it, which depends on what stipulations the agency puts on it. He said that as mutuals or community groups pursue this, it probably is not a one phone call discussion.

Ms. Schwadron said that the door is always open. OCC staff cannot help mutuals with who might be interested in buying it the instrument, but they can help look at the different arrangements and determine whether it would meet the criteria. It is not just CET1, there is a tier one capital requirement, additional tier one. If they can meet all the legal obligations for being a mutual that can pay a return non-cumulative, and they could set a rate on that. That gives more certainty to the investors of a return, but it is still not guaranteed.

Mr. Brickman said there has been banker feedback on a trickle down to community banks from the capital proposal. He said that rule has specific asset threshold about which banks it would apply to and, the proposal that is out does not apply to community banks. There should be no fear that there is a second wave coming in terms of rulemaking that would ratchet up the requirements at the community bank level.

Ms. Schwadron said that the comments about the mortgage market and depending on how the agency finalizes a rule, there could be applicability to the mortgage market, particularly for low- and moderate-income mortgages.

Member Roundtable

Mr. Brickman welcomed Michael Hsu, the Acting Comptroller of Currency, and Beverly Cole, the Senior Deputy Comptroller for Midsize and Community Bank Supervision. He told the Acting Comptroller and Ms. Cole that the Advisory Committee had an in-depth conversation on the mortgage market and the general economic landscape. There was a specific update on kind of mutual trends within OCC supervision.

The Acting Comptroller said that he had several questions for the Advisory Committee members, but he wanted to take the opportunity to hear what is on the members' minds. He asked how the Advisory Committee's customers are doing, how the employees are doing, how are the communities doing and what is the members' view on the outlook. He said that there are a lot of mixed signals right now in terms of the outlook. He is curious to hear what the "on the ground" view is. He gets reports from a number of sources at the OCC, but he wants to hear directly from the Advisory Committee members how things are going, what they are worried about, what are top of mind issues.

An Advisory Committee member thanked the Acting Comptroller for the advocacy that the OCC has been doing for minority depository institutions. He said that the Advisory Committee had had a joint conversation, with the MDIAC. It is an interesting model and there are some mutuals who are looking at using that MDI model as they look to serve underserved communities. He said that anything the OCC can do to further that model would be welcome.,

The Acting Comptroller agreed and asked Mr. King to respond. Mr. King said that he appreciates the energy at the MDIAC meetings and this topic was brought up again at the most recent MDIAC meeting to determine the interest in engaging with the MSAAC and see what kind of synergies and challenges there are. He said the structure for working together has to be determined, but there a lot of interest. He said that OCC staff will work to organize a collaborative event.

An Advisory Committee member said that the bankers are the same. They need to get in a room and figure out how to make it work, to have the conversations and hopes that it can lead to some constructive solutions down the road. There are mutuals actively looking at it. The OCC has been great to work with on that. There are some differences in how the FDIC and the OCC looks at MDIs.

Mr. Brickman said that there have been several conversations with mutuals and other organizations that are interested in pursuing an MDI business model and the steps they would have to take in order to get that designation. Mutuals themselves have unique challenges because one of the key drivers of an MDI designation is ownership. Obviously in a stock institution, it is a different calculation than in a mutual. For mutuals, there is an alternate test but for mutual holding companies it is more challenging. OCC staff is working through those thorny policy issues.

Mr. Brickman said that there are two strong, positive tracks for an MDI/Mutual collaboration. One is the collaboration piece, which is how are minority markets served. That piece is accomplished by working with MDIs to understand their business and outreach strategies and tips to understand how to get better penetration in areas where there is a certain customer subset. The other track is the bigger picture, which is if the mutual wants to change its whole business model and become an MDI that focuses on those minority communities or those types of activities. That is a bigger undertaking, but it is one that OCC staff is engaging on because the agency strongly supports the MDI population as it exists, and would like to see it expand and grow, because there is a valid need for services for a lot of communities across the country.

An Advisory Committee member asked the Acting Comptroller what are his views on deposit insurance reform. The Advisory Committee member had looked at the FDIC analysis on deposit insurance reform earlier in the year.

The Acting Comptroller said that he would employ a classic examiner trick and turn the question back on the member first. He asked what the member thought of the FDIC's report. The Advisory Committee member said that he was impressed with it because it provided the whole history of deposit insurance in detail, leading to the present and the current challenges. He also thought it was interesting that it was not conclusive in that it discussed the four options that are on the table and put the ideas out there to stimulate conversation. He said it raised ideas he had not thought of.

The Acting Comptroller said that he had a similar reaction. He said because he is on the FDIC Board he was as made aware shortly after the failure of Silicon Valley that the FDIC was going to put something together. He said that he thought they would not be able to put it together quickly. It is a fantastic report because it puts the whole history of deposit insurance into context. FDIC really wanted to have an active and balanced debate about what the options are laying out the pros and cons objectively for folks to consider, especially Congress.

He said that changes would have to be a decision by Congress as to which option to do. He said that he has stated his view publicly, that he is partial to the third recommendation, which is to focus on business transaction accounts or business payment accounts. He said that to the extent that there is some expansion of deposit insurance, that strikes the right balance between capturing a set of deposits which should be relatively sticky and serve a huge function economically without running into moral hazard issues or breaking the bank in terms of costs to the DIF. He said that it seems like a good analysis. Since the report came out OCC staff has done some work on looking abroad to see what are the deposit regimes in other countries and how the US compares.

The Advisory Committee member said that in recent years after bank failures the agencies have immediately said all deposits are covered and insured. He asked whether through those actions, they have suggested that is going to be policy going forward.

The Acting Comptroller said that the statements have not said that all deposits are all insured, but that they are "safe," and by saying deposits are safe, some of them are explicitly insured by FDIC insurance. The uninsured deposits are handled through supervisory means, the agencies make sure that banks have sufficient liquidity to cover any withdrawals on uninsured deposits. Many banks have gotten supervisory feedback about the need to strengthen liquidity profiles. That way the agencies can tell the whole world, that deposits are safe, which is important. The statement has to be credible, but the agencies do not have the authority to expand deposit insurance without Congressional action.

The Acting Comptroller asked the Advisory Committee members how their customers doing and how are they feeling about the economy. An Advisory Committee member said that his customers are cautious at this point. The economy in his location is pretty consistent. There is a lot of defense spending and that is positive, there are still challenges with skilled employment. He said that people are optimistic about a potential soft landing, and that housing is still a huge issue.

He said that his bank has a good consumer deposit base. The challenge that the bank is facing is deposits and they are able to keep deposits, but pricing is a challenge. People are cautiously optimistic. The bank watches the commercial office space and is amazed at what warehouse and manufacturing space is going for. Companies are knocking down office buildings and putting in distribution centers. The Advisory Committee member asked a question about the CFBP's rule on 1071 that requires small business data reporting.

The Acting Comptroller said it is the CFPB's rule. The other agencies coordinate with them to the extent possible. He said that in connection with CRA, the agencies are in the process of finalizing the rule. He can not say too much about it, but in terms of data collection, the agencies have made a very conscious effort to try to sync those requirements so that there are not duplicate reporting requirements. The agencies will have to keep a close eye on how the 1071 requirements develop, relative to what the CRA requirements are going to be.

The Advisory Committee member said that he has said it before and he knows there is not much that can be done but he thinks that what everybody has missed is the invasion of privacy from the perspective of the business customers, especially in a small community, as the information becomes public. He said that he has gotten pushback from customers on the collection of the data. He thinks it is well intended, but it may force businesses to borrow from nonbank companies, and those small businesses may be out of the banking system.

The Acting Comptroller said he has heard that feedback in forums like this and privately. He thinks that through the comment process it has been flagged as one of the unintended consequences. He said that he does not want consumers to leave the community banking space because of what they see as an invasion of privacy.

An Advisory Committee member said that in his area, there is an influx of people buying homes with money from the sales of homes in Florida. They can not afford the taxes or insurance in Florida anymore. He said they are having supply and demand problems in his area. He said that he is concerned about changes to the CRA requirements that will drive large banks into community banking to try to get more loans where they are getting their deposits.

The Acting Comptroller said that he can not say very much. He said that that the agencies proposed that the assessment areas would be where bank facilities, branches, ATMs, are based. They proposed retail lending assessment areas, which are not based on the deposits, but based on the bank's existing lending activities. That is different than linking the assessment area to deposits, which is a different formulation of how to modernize the CRA. He said that the agencies received a lot of comments from community bankers. The agencies take all of the comments seriously. He said that the agencies will not make every commenter happy.

An Advisory Committee member asked for the Acting Comptroller's view on the increase in fraud. The Acting Comptroller said that it has caught the OCC's attention. He said that check fraud is up astoundingly, and it has caught everyone by surprise because it feels like a throwback. It is an industry-wide issue. He said that he understands that there are a number of conversations taking place in different forums among the trade groups to ensure that the larger banks are responsive. He said that he recalls that this Advisory Committee raised as an issue the timeliness and responsiveness of large banks when community banks try to get a situation resolved.

The Acting Comptroller said that other than check fraud, there is more sophisticated, synthetic fraud. He said that with AI it will get worse before it gets better. It argues for being very attentive to controls because there is pressure for the seamless customer experience, but that is what creates room for fraud to occur. He said when instant payments, including Fed Now is layered on, all the points in the chain have to be equally robust.

An Advisory Committee member said that his bank has experienced quite a bit of check fraud and his area had extensive mail theft. He thinks that somewhere the industry has to figure out how to more appropriately apportion the liability. He said that the industry has to look at the liability on the bank that is accepting and taking the fraudulent checks.

An Advisory Committee member said that they see certain industries experience check fraud more often. Some of the builders who write bigger checks feel like they are doing all the right things, putting it in the post office box itself, but there is still fraud. When the bank works with small banks to get a resolution, it can be resolved but when they work with some of the larger banks it is more challenging, it is up to the mutual bank to work it every day. The big banks do not give much help.

He said that his area is doing pretty well but there is a shortage of rental housing. It is one thing if people cannot afford a house, but it is another thing they cannot afford shelter. Leases are increasing up to 40 percent more to stay in the same rental unit. He said that eventually they think they would see past dues or problem loans, but not yet. On the commercial side, despite the higher interest rates, they are not seeing anything yet. They are watching more closely those customers that are interest rate sensitive with floating rate, debt, or lines of credit. Most of those customers have been able to raise their own prices to pass on to their customers. At this point, it has not materially affected the customers of the bank.

Another Advisory Committee member said that his bank's loan quality is good overall, but they are seeing a little bit of stress with a few more borrowers lagging on their payments. The bank needs to make a few more phone calls to get those payments in. He also said that families are being priced out of the housing market in his area.

An Advisory Committee member said that his bank is doing a decent job lending money and taking in deposits, but they do a bad job marketing. There is a lot of competition in the area for all banking services. The problem is gathering new deposits and getting new customers. Lending has become a commodity. He said his bank cannot differentiate itself on the deposit side. It cannot compete with all the other non-depository institutions that have jumped into the deposit arena.

He said that gathering deposits has been increasingly difficult and not just from the standpoint of changes in the competition. He thinks it is a marketing problem because the customers that they have are community focused people that understand when they bank with a community bank the money is going back into the community. When customers make deposits in a regional or national bank, it is usually not. The Advisory Committee member asked how they can get the new customers or how do they reach out. The existing customers might be doing fine, but it is hard to gain ground with new customers. The bank has a great story, with good benefits and customer service but they cannot make inroads.

The Acting Comptroller asked whether it is generational or is that a combination of things. The Advisory Committee member said that some of it is generational where the deposit is a deposit is a deposit, the customer does not care where it is going. But there are market segments where the banks can take that segment and compete on rate or on loyalty and community. He said how does the bank get the other consumers to understand that the farmer's market is better than the chain. It is hard to communicate that.

An Advisory Committee member said that his bank struggles with competition from credit unions and they went through a marketing process and looked at what credit unions are doing. The message is almost always, the credit union is here to help you. The bank has so many customers that are the better commercial customers, and the bank had the discussion that it wanted the lending customer's checking account. There is a disconnect, especially among the younger generation. They say that have their loan and the mortgage, but it is hard to change a deposit account. The bank has had to change the messaging to reflect that the money that the customer deposits with the bank is what is going back to make these loans for the customer.

An Advisory Committee member said that if the bank takes more of the marketing budget to social media, they have had some moderate success with younger people responding when looking for a mortgage or a construction loan. Particularly in the mortgage area, the bank gets a surprising number of younger people coming in. The bank has a good reputation for being local and buying local.

The Acting Comptroller said that he thinks that the competition for deposit money is not going to go away, and it may intensify. Competing on price is going to be very hard to sustain over time. For community banks strategic risk is highlighted is one of the top three risks. For example, what is the longer-term business plan, especially in terms of new customers. Where are the new customers coming from. Diversity comes up in a business context, for example having staff who are from different walks of life, whether it is gender, ethnicity, age, profession is important and they bring more experience and insight into what customers want and need.

The Acting Comptroller said that he thinks it is really important for the US economy to have a diverse economy. It is big economy. There is plenty to go around. The large banks do not want to serve every single little last segment. There is a long tail of communities that are looking for something special and that is what the Advisory Committee members have to offer. Now the question is how do the banks match that up. For the OCC this is where having the Advisory Committees helps staff because it adds to the diversity of perspective. Maybe this is something to think about a little bit more is how does the bank get other perspectives at the table to give that feedback about what marketing will work.

The Acting Comptroller said there is a strategic aspect which is probably worth exploring a little bit. He said that maybe this is where collaborating with the MDIAC is valuable, for example discussing how they approach the customer base or how do they approach growth.

An Advisory Committee member said that one thing that sets mutuals apart is the relationship with customers and the community. An Advisory Committee member said that they put their money where their mouths are. The banks are in a position where they can give back financially with bank staff hours to the community in ways that it does not look like big banks, medium sized banks or even some credit unions are doing. He said that if the industry is going to survive, it is going to be based on relationship aspect of banking. It does not appeal to everyone, but it appeals to a lot of people.

An Advisory Committee member said that at this size he can raise relatively amounts of money in wholesale funds and change the balance sheet. He said that he can do that with Quick Rate CDs quickly. He can do that in a morning, but if he wanted to raise that amount of money in the community, it would take newspaper ads and marketing and bank staff doing outreach.

The Acting Comptroller said there is a lot more focus now on liquidity risk profiles, especially related to deposits in part because what of what happened in the spring. He said that what the members are sensing from examiners "is hope for the best, prepare for the worst" because things can change in really challenging ways.

An Advisory Committee member said that in 2002, when banks thought they would never have liquidity to fund the institution, it was all wholesale. He said that his bank is fortunate. It is in the fourth percentile in cost of funds. He said that legacy customers of other banks do not come around if a bank moves to another market.

The Acting Comptroller said that one caution is in the mid nineties when rates backed up there were some institutions which were hoping that things would quote unquote normalize with rates falling back down again. They did not and they stayed elevated for quite some time. He said it is becoming clearer now, the elevated rate environment will remain for quite some time.

An Advisory Committee member said that his bank staff know all its large depositors and they make sure they do not have anyone walking away that will cause the bank an issue. As mutuals, as a whole, they have got a broad base of depositors that fund the banks. They do not rely on one company or entity. He said that looking down the road as mutuals, they have the ability to plan more long term.

An Advisory Committee member said that he can grow. There is a line out the door for lending because the bank can differentiate itself and has a competitive advantage. He said he can be better than the next guy just because of the model, but he cannot do that with deposits. He said that the way he can look at strategically growing is through acquisition, which is also buying their problems as well as their liabilities as well as their assets.

He said that he does not mean deposits and assets in real terms. He means in strengths and weaknesses. As far as acquiring new customers he thinks the conversation with MDIs is so important. His bank is in that market, but they could do much more by going to community events and other activities.

The Acting Comptroller said that a mutual's comparative advantage is relationships. The answer is going to lie somewhere that relationship. It is not going to be on price, it is going to be on relationships. He gave an example of his brother who lives in East Oregon. He has a friend who is an auto mechanic and for a long time was a SAAB service specialist and at some point, he realized SAABs are not going to be around for a long time and switched to servicing electric vehicles. Then he realized that a lot of the frictions with auto repair were gender based. He hired all female mechanics, and he is cleaning house because women are often the ones who bring in cars and they trust other women.

He said it is an imperfect analogy, but there is something to it. There are lots of consumers who want a relationship with their financial institution. It is not everyone, if they want to price shop, they will price shop. There are still plenty of consumers who care about certain things. It argues for who those people are and where they are. He said that he has heard interesting stories of community banks with a change in leadership and they look at their community differently and maybe they hire different tellers. They are bringing in different staff who have got a different perspective.

The Acting Comptroller said thanked the Advisory Committee members and said that there are a couple of follow ups for the MSAAC and the MDIAC members to meet and he looks forward to hearing about those discussions.

Mr. Brickman asked the Advisory Committee members if they had any feedback on how the OCC is doing on the supervision side in terms of examinations, and examiner knowledge of both mutual specific issues and then more broadly community bank issues.

An Advisory Committee member said that his bank completed an exam within the last two months and, were worried about it for a lot of the issues that have been discussed. It was a well-done exam. It was very thorough, but that is good.

Another Advisory Committee member said that they had recently had an exam as well and he agreed that they are getting better. The one area that he suggests that something change is vendor management. The bank has some local vendors but one of the comments on the exam was about having a bank employee review the financial statements of financials and go through the data of the core provider and the insurance company. He said that for small banks looking at the financial statements of large service providers that are used by many banks does not make sense.

Mr. Brickman said it would surprise him if any examiner at the OCC was saying that the bank needs to do a deep dive into financial statements or a deep dive into corporate governance at a core provider. A bank can rely on a surface level review of financials. He also noted that a bank can request a copy of the ROE to check for deficiencies, but examiners should not be pushing for a review that goes deeper, for example a review of board composition. He said that reviewing the document is a central piece of the bank's due diligence. There is a third-party report on service providers (SAS 70) that the OCC typically acknowledges as being the equivalent of an independent review that if the bank were to review that and get an understanding of the company. It is a high-level succinct summary of an independent party's review of that service provider. If the bank has the SAS 70, has the OCC or FDIC or the Fed report of exam, and the bank looks at the public financial statement. He said the bigger part of vendor management is seeing are they complying with the contractual terms and obligations of that contract. Are they remediating known IT deficiencies, which would be identified in the SAS70 or in the OCC's reports. Those are the high-level things the OCC would want to see the bank doing. He said that the agency's third-party risk management guidance does a good job of defining what is in scope versus what would be out of scope in terms of the depth of analysis.

Mr. Brickman said that in MCBS, there is a project to develop a portal so that portfolio managers will be able to access a system within the OCC to search for a vendor name and find out whether it is a regulated vendor and if the agency has a report of examination. The portfolio manager will be able to confirm that a bank is a client of that vendor. They can then send the bank the open part of the report.

He said that the portfolio manager would have to confirm that the bank is client of the company, because the agency only releases reports to the people have signed contracts with those companies.

An Advisory Committee member said that his bank was going through an exam as the Silicon Valley Bank situation unfolded. The prior exam has started during the pandemic. He said that the younger examiners are sharp and well-trained. The examiners understood a number of things, especially on ALCO that were helpful. The bank staff were very impressed with the examiners' knowledge base. An Advisory Committee member said that the exam team at his bank added value in specialty areas, for example trust.

Mr. Brickman said that as part of the MCBS realignment, the OCC tried to pick the instances where it was important to have local expertise, but then also recognize where technical expertise, which had no bearing on the physical location of the bank. For example, an examiner does not need to know the local marketplace to understand IT risk.

An Advisory Committee member said that the trust examiner was virtual, and they had been a trust officer in a bank and, asked the right questions and challenged the bank on some things that it needed to look at harder. An Advisory Committee member said that he had an exam that concluded two months ago. He said that over the course of time the bank has involved the chairman as part of the executive management team. Every time the team meets, regardless of the topic, the executive team hears the same story, and one person is not misinterpreting the message. He said that he thinks that the examiners have appreciated the chairman attending those meetings. He also said that he would echo the comments about how smart the younger exam staff is.

Mr. Brickman asked Ms. Bahin to provide the dates for the meetings in 2024. She said that the dates for 2024 are March 5, June 24 and 25 and October 22. She also said that she would work with Mr. King on a meeting with MDIAC.

Mr. Brickman let the Advisory Committee members know that in 2024, the charter of the Advisory Committee would be up for renewal and the terms of the members would expire. He urged the Advisory Committee members to think about other mutual bankers who would make contributions to the Advisory Committee. He also asked the Advisory Committee members to consider how best to structure a collaboration with the MDIs. He also said that the review of the regulations that occurs every ten years has started, and he asked the Advisory Committee members to keep that in mind if there are requirements that are particularly burdensome, to let OCC staff know.

Public Comments and Adjournment

Mr. Brickman said that the final thing on the agenda is the public comment period. He was monitoring the chat and no public comments have come in. He remined anyone participating virtually that they can use the chat feature of the webinar to input a public comment.

He asked whether any member of the public in the room wanted to make any comments.

Joe Pigg from the ABA thanked the OCC holding the meeting. he said it was informative and the information is important. The discussion of capital certificates and working with MDIs was especially useful.

Mr. Brickman adjourned the meeting at 2:30 p.m.

Certification

/s/

Michael R. Brickman
Designated Federal Officer

Appendix A

Questions for the Mortgage Discussion as part of October 3, 2023 MSAAC Meeting

General:

- What issues and concerns are the markets in your geographic footprint experiencing with respect to supply, marketing times, and property type availability?
- Have higher interest rates changed the mortgage market in your area?
- What are employment levels in your area? Have you seen any noticeable changes in the types of available employment?
- In the past few years, several members noted that house prices were increasing in their areas. Have prices stabilized? Are other trends emerging?
    - Have supply chain or other costs that impact housing costs stabilized? Can you speak to the factors that are currently impacting house prices?
        - For example, supply, building costs, demand, et al.? Are there others?
- What was/is the general direction of your institution going forward? Are you concerned with the general direction of borrower needs/acceptance of risk by lenders?
    - Do you originate loans that you are able to sell to the GSEs that you would be reluctant to hold in portfolio due to higher risk characteristics (higher DTI, lower score, higher LTV) or layering of such characteristics?

Origination

- In the past, this group has discussed the competition from nonbank competitors.
    - How much market share do you think that you are losing to NDFIs? Is the amount increasing each year or does it vary?
        - Are some products more likely to be originated by NDFIs than others? Has that changed in the current rate environment?
- Do you see an evolution in the product mix that nontraditional mortgage lenders are offering that impacts your competitiveness? To what extent are you using agency versus non-agency products to meet your customers' needs or requests?
    - The GSEs continue to adjust their lending standards, some of which adjustments are intended to make housing more attainable.
        - Are you seeing a discernable easing of the standards for the acceptance of qualifying loans?
- Did your funding base change because of the pandemic? Has it returned to pre pandemic sources or levels? Or has it changed permanently?
- Has the demographic of the borrower changed, for example, are millennials buying homes? Are more homes available for first time homebuyers?
- How important is technology to your customers?
    - Did you make changes during the pandemic to accommodate customers?
    - Do you still use the technology or processes? Have they evolved even more?

    - Have you continued any new processes that you developed to accommodate changes in the processing or underwriting of loans during the pandemic?
- Are you taking a more/less a conservative approach in lending to new borrowers or refinance customers?
    - Are you using overlays or process adjustments to any of your offerings?
- Concerns with the appraisal process have come up in the past, have there been any positive or negative developments in the past year?
- Have the changes in interest rates forced changes in the loan products you offer? Have you made changes to meet competition?

Servicing

- Is the increased use of technology in originations reflected in changes to make servicing more efficient?
- To what extent are you using sub-servicing, performing, non-performing?
- Are you offering forbearance/loss mitigation activities to any customers' loans that are on book?