Office of the Comptroller of the Currency
Minutes of the Meeting of the
Mutual Savings Association Advisory Committee
October 22, 2024

The Mutual Savings Association Advisory Committee (MSAAC) was convened for a meeting at 8:30 a.m. on October 22, 2024.

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, Thomas Newbern (virtual), David Reynolds, Thomas Rudzewick, Steven Sloup, Brian Smith and Samuel Wilkinson

OCC Staff Attending

Michael Hsu, Maria Adams, Jason Almonte, Charlotte Bahin, Julie Blake, Greg Bost, Amanda Brennan, Michael Brickman, Beverly Cole, Christopher Crawford, Chau Do, Daniel Grantham, Cesar Gutierrez, John Harootunian, Allison Hester-Haddad, Anne Kerttula, André King, Amy Klien, Ernie Knott, Mariya Komartsova, Shari Lamar, Paul Moloney, Donna Murphy, Erica Onsager, Heidi Pawelczyk, Kathryn Ray, Joe Smith, Demetria Springs, Tracy Velez, Troy Thornton, Natalie Tiernan, Matthew Vick

Public Meeting
Introduction and General Remarks

Michael Brickman, Deputy Comptroller for Specialty Supervision, welcomed the members of the OCC's Mutual Savings Association Advisory Committee and noted that this is the final meeting for the current group of members. He thanked the members who would conclude their membership on the Advisory Committee at this meeting. He explained why he was participating in the meeting virtually and he noted that an Advisory Committee member was also participating virtually.

Mr. Brickman introduced OCC staff who were present and would be part of the agenda: Daniel Grantham, a Senior Financial Economist, Joe Smith, a Technical Expert in Mortgage Banking Risk, and Ernie Knott, a Financial Analyst. He also introduced the Midsize and Community Bank staff who were present: Charlotte Bahin, the Senior Advisor for Thrift Supervision, Amy Klein, who represented the West and Midwest regions, and Beverly Cole, the Senior Deputy Controller for Midsize and Community Bank Supervision. He noted that Paul Moloney from the banking condition area was also present. He said that the Acting Comptroller planned to join the meeting after lunch for a Roundtable Discussion.

Mr. Brickman encouraged the Advisory Committee members to participate in the meeting because the goal of these meetings is to hear directly from the members, the bankers who are on the Advisory Committee. OCC staff is interested in what is going on within the local communities, and more broadly within the mutual banking sector. It helps inform staff in order to know if the agency needs to make any adjustments to its supervision or policies in order to better suit the mutual industry or what is going on within the industry.

Economic Update

Daniel Grantham began the Economic Update. The presentation is posted on the MSAAC page on OCC.gov. He said that there is a lot going on in the economy, but at a high level, GDP growth remains very robust. He began by looking at slide 2. He noted that looking at the individual numbers what is important from an economics perspective is looking at the green and blue bars for consumption and investment on the slide, which are the two areas that preview future economic growth.

He said that consumption drives the economy. Investment remains positive for GDP growth. Looking forward, Mr. Grantham said that economists look at the blue-chip forecast, shown as the blue bars on the right of the slide.

The forecast has been revised upwards in recent quarters with stronger-than-expected GDP growth. The forecast calls for about a two percent growth over the next year and a half. The Federal Reserve Bank of Atlanta has developed a real-time estimate for the relevant quarter GDP. The forecast currently is for 3.5 percent GDP. The forecast is comprised of real-time indicators to make the estimates. It is one indication for the level of the economy however it is not always accurate, but it does give a sense of what recent data are indicating.

GDP has continually increased, although the expectation for quarters going forward is more moderation. He said that looking at the numbers, it is difficult to see where the moderation may come from.

Mr. Grantham turned to the third slide. He noted that the unemployment rate has been getting a lot of attention in the press. He explained that for retail credit and loan performance, it is a key determinant in what happens going forward. The slide shows a long series of the unemployment rate beginning in 1960 and there have been many ebbs and flows. The historical information puts the current increase into perspective. It has risen quite a bit, but historically, the unemployment rate remains low. He highlighted the little uptick on the bottom right of the chart and said that because the financial press focuses on the last 18 months, they see a 60-basis point rise. The increase in the unemployment rate generally is a warning sign, but given the relative levels of reaching about 4.2 percent to 4.3 percent it is in line with what is expected in a healthy economy. Going forward, the blue-chip forecast causes anticipation that the unemployment rate will oscillate around this normal operating level.

Mr. Grantham mentioned that the recent sharp uptick in the unemployment rate has garnered a lot of press. One of the areas is what is called the Sahm rule. He turned to slide four and described the Sahm rule. He said that generally it says if the unemployment rate rises 50 basis points above the 12-month low, the U.S. economy is in a recession. This level was reached in July, this is not an economic tenet, but there is no economic theory behind it. Statistically, the times where the economy has reached this 50-basis point threshold going back to 1960, the U.S. has been in a recession. The creator of the rule has said that this period is probably different because of the pandemic, a lot of the deviation from the norm in the current labor market, the relative level of a starting point of three to 3.5 percent unemployment rate and the rise in unemployment rates, traditionally is an indicator for being in a recession. Mr. Grantham said that he does not think that is the current situation. He said that when the data are reviewed more closely, as shown on slide five, this time period is different.

He noted that the arbiter of which entity officially declares whether the U.S. economy is in a recession is the National Bureau of Economic Research, the NBER. They look at six main measures for whether the economy is in a recession, two for employment, one for industrial production, manufacturing and trade sales, personal income excluding transfer payments, this is Social Security, Medicaid, Medicare, and then personal consumption. In looking at recent recessions, excluding the pandemic, which was unusual, and looking at the indicators when the Sahm Rule was triggered, the economy is contracting across all these measures.

When the rule was triggered in July, all of the measures except one were positive, indicating a healthy, growing economy. He said that he is skeptical when anyone says this time period is different, but when the underlying data are examined, this time period is different. The broadest measures for the economy's health are indicating a growing, relatively healthy economy, despite the uptick in the labor market.

One of the challenges, particularly for the Federal Reserve, is making the judgment calls in semi-real time. Economic data are subject to revisions. Looking at slide six, data revisions are a way of life, with the GDP in particular. Within a month of quarter end, the Bureau of Economic Analysis releases the advanced estimate for GDP. It comes out within three to four weeks of the of the quarter. The third quarter numbers will be released next week. This advanced estimate only incorporates the first two months of economic data in a quarter.

One-third of the quarter is missing in that advanced estimate. As more data become available to the Bureau of Economic Analysis, they revise the estimates to incorporate remaining quarter. It is important to recognize the advanced numbers that the Federal Reserve has at its disposal when they are making policy decisions are not reflective of reality or what the final numbers are.

The slide shows the advanced GDP estimates that come out three to four weeks after quarter-end compared to the revised estimates which include the whole quarter. He notes that it is obvious that in the beginning of 2022, the economy had two negative quarters of GDP growth. The textbook view at the time was two quarters of negative GDP growth is a recession. But was the U.S. in a recession? The view was to take a broader look at whether to review and decide how the U.S. economy is functioning and whether it is in a recession. But the negative quarter of GDP growth on the second quarter was actually revised to be positive.

Making policy in real time is difficult. As new and better data becomes available, it changes the perspective of what is happening in the economy. For example, real GDP growth a couple weeks ago was revised for the last couple of years and subsequently added about 1.3 percent to GDP growth. The economy has been growing faster than was originally thought, even in the prior few weeks. Some of the areas in which this has been evident make a difference. He turned to the seventh slide and noted that real personal disposable income was revised upwards by almost $700 billion.

Mr. Grantham said that there are a couple of different ways to think about and look at this increase. The $700 billion has been paid out and is already out there. Most of the money has been spent. But it does change how economists think about and view the U.S. consumer and the economy. The original numbers in the dotted line on the slide show stagnating real personal disposable income. The revised numbers indicate a growth in real personal disposable income. It is possible to use the data, and by parsing it see where this income has come from.

He said that he thinks it is important to do that. The $700 billion on its face is a relatively large number in the large, advanced economy, but it only translates into about two weeks of personal outlays or spending. In the grand scheme of things, it is somewhat modest. But when the sources are looked at, besides the net current transfer receipts, which would primarily be Social Security, income on assets was a huge driver of this income in areas that tend to go towards higher income. This may not reflect the financial health of consumers on the lower end of the income spectrum.

Another key measure is that it dramatically changes what the reported personal savings rate has been. That has been an area that has received a lot of attention. Mr. Grantham turned to slide eight and looked at the personal savings rate. The personal savings rate has been at the lowest levels over the last 20 or 30 years and indicates consumers might be stressed. The dotted line in the chart reflects the original estimates that were reported that show a personal savings rate of about 2.9 percent.

The revised numbers suggest that the personal savings rate is closer to five percent, which is more in line with the pre-pandemic average, suggesting a financially healthier consumer. Some of the lower personal savings rate may be natural for an aging economy.

A large group of baby boomers is entering their retirement years. It is natural for them to save less or spend down their savings as they enjoy retirement. Some of the data could be driven by demographics, but the reversal or revised data changes the perspective of the view of the consumer. Generally, consumer wealth is high. Incomes adjusted for inflation are higher than they were in 2019.

They are even higher than what was originally expected. And here the personal savings rate is higher than it was originally thought to be, things look rosier than they did even three to four weeks ago.

He said that he hopes that it provides some perspective about how economists think about the economy, the kind of data that are used and how they are subject to change as new information becomes available. The real kind of bugaboo in the economy that receives a lot of attention continues to be inflation. He said that he would spend some time talking about it beginning with slide nine. There are two widely reported measures of inflation, but the Federal Reserve looks at core PCE inflation. This measure excludes food and energy. It tends to have lower estimates for inflation than the more widely used BLS figures or the CPI. But they are targeting about a two percent level of inflation.

And the three bars on the chart represent the recent three drivers, core services excluding housing, housing on its own, and core goods. Core goods have seen prices fall, which is not unusual. It has occurred a lot since the 2000s. A lot of goods made overseas are continuing to show price decreases that help the U.S. consumer. But much of the price growth has come from core services, excluding housing, and housing on its own. Housing has been a bit of a conundrum.

Over the last couple of months, market rents show declines or a slowdown in growth. The general thought was that the numbers for housing would start to flatline and not contribute to price growth on about a six- to 12-month lag, but that has not happened. Mr. Grantham said that there a number of theories about why this occurred, but no one really has a solid answer for the divorce between market rents and what the published figures show. He asked whether the markets in which the Advisory Committee members operate show any signs of easing in residential market rents. The Advisory Committee members responded that they are not easing in their markets, or, if they are it is very slight.

An Advisory Committee member asked whether the inflation rate is going to get below two percent. Mr. Grantham said that it depends on how the data are reviewed and parsed. Some economists can look at month-over-month or quarter-over-quarter.

He said that if housing is subtracted out, which some economists would do and use just core services, it is at two percent or slightly below. Some of the Federal Reserve's justification for cutting rates 50 basis points is a result of the slowdown of core services, but the housing number maybe not be reflective of reality. Getting the published figure below two percent is challenging, particularly in looking at the information on the next slide, which shows the wage growth slowing, but not slowing down enough to get to two percent.

He said that it is hard to say, especially in the geographic areas where the Advisory Committee members say their experience is that market rents are not coming down. One piece of the data is not pointing in the right direction, and it might be how market rents are collected. An Advisory Committee member said that he has noticed that in New York City area the barrier for entry for first-time homebuyers is high. None of the property values have come down, and the prices of starter homes are being driven up. Without any new construction, infill housing is a big piece of real estate for housing in New York City. The Advisory Committee member said that he does not see first-time homebuyers able to make down payments or carry costs. Another Advisory Committee member said that was reflective in his market as well.

In another Advisory Committee's market, starter homes are $400,000, and wages are not close to the median wage versus the median home value, even the tax value. There is a mismatch and consumers cannot afford homes. The Advisory Committee member noted that it is a big challenge, but there are programs that banks have and federal grants available to first time homebuyers. The banks need to ramp up participation in and availability of the programs for there to be any opportunity for first time homebuyers. In the New York City market, there are co-op and condominium markets that can provide first time homes, but what is being built is unaffordable. He also noted that the city is trying to work out its own housing zoning issues, but the current administration is under pressure from other factors. He said that consumers are squeezed from every angle. He noted that the 30-year fixed mortgage rate is high and housing supply is low.

He said that the housing supply in his area is very low. He is not seeing a lot of construction and what is being built tends to be larger and more expensive. It is hard to see any sort of amelioration in the next couple of years. Another Advisory Committee member said that first-time homebuyers really struggle to get in the housing market, but loan demand in their geographic area, Missouri, has been robust for the past full year. He said that they need to slow down on the loan side. He said that the loan book is across the board with one- to four-family mortgages, construction and new builds.

Another Advisory Committee member said that they are starting to see a slowdown in the origination of one-to four-family loans, but that labor costs are not coming down. Housing costs, material costs, are not rising but they are not coming down. The price of land is not coming down and for a builder to build an affordable house, it has to have a forehandle on the price. Unless it has major subsidies from the government.

Mr. Grantham agreed that there are many challenges and that it is hard to see a solution coming in the next couple years. He turned to slide 10 which shows the growth of compensation and core PCE services, excluding housing. The core PCE services, excluding housing, is about 60 percent of the basket of goods for the PCE indicator overall. It tracks closely to the total employee compensation. Over the past two years, there has been some easing where growth has come down from close to six percent to closer to four percent. The impact is positive on inflation.

However, it is still not at a level where inflation could be at the two percent target. He said that it would be interesting to see what are the changes as additional data come out. This slide only shows data through the second quarter of this year, but driving this core PCE services down is the slowing wage growth that has started. However, the level is not sufficient enough to get there.

He asked the Advisory Committee members whether they have seen a slowdown in employee compensation their markets. The Advisory Committee members said they have not seen a slow down on the banking side or in other industries. An Advisory Committee member said that there is less turnover right now, which indicates something. He said that the salary pressures come from the entry level employees and the bank trying to compete against Amazon and some of the big companies that pay much higher wages than the bank. He said that they have to adjust to do that.

The Advisory Committee member said that the bank's local small business customers have to do the same thing. Eventually, increases in salary would be passed on somewhere. Mr. Grantham asked whether anyone seen salary growth commensurate with where they were two years ago. The response was not at that level.

An Advisory Committee member said that he noticed that a turnover in employment. He noted that there are a lot of older employees that are aging out. He said that when he speaks to younger groups of people, they are anxious to enter the market.

An Advisory Committee member described attending a high school event that week, and he was asked to come back to talk about business building opportunities and speak to some of the graduates or the seniors that are graduating about what opportunities there are in banking. He noted that banking touches so many different sub-industries. There is a growing group of people that are ready to fill some of those jobs. But in terms of where the salary ranges are, they are going to start at a much higher place than some of the ones that are aging out.

He said that is going to put a lot of pressure on the noninterest income. Compensation is probably the fastest growing area, at least in his institution. An Advisory Committee member asked whether Advisory Committee members were seeing younger workers use a slowdown or quiet-quit trend where remote work was almost a game to see how remote they could get and how many jobs they could hold in a 12-month period? He asked whether that is slowing the quiet-quit trend? Another Advisory Committee member said that they are seeing that trend.

They reported that they are a seeing a return to the office. An Advisory Committee member said that he judges the return to office trend by the amount of traffic he encounters going the 26 miles to his bank, how many hours it takes him to get to work. In the New York City area, he thinks there is a push to get back into Manhattan offices.

He also noted that for the largest banks, there is a push for employees to get back to the office five days a week. He said he does not know how successful they will be. He also said that there are newly hired employees who ghost new employers.

He said that it is not happening as often now where somebody will take a position and then just not show up. That is not happening much anymore. There is a more responsible trend of coming to work in the office.

In the New York metro area, the major employers like Amazon, IBM, PepsiCo are requiring return to office. It is causing issues with the senior employees who have gotten used to managing the remote workplace a little bit better. Now there are top-down things happening where employers are requiring four days in the office no matter what and that means people traveling more and going back more.

The Advisory Committee member said that smaller businesses are following the example as they see the impact of the larger businesses. Another Advisory Committee member said that in terms of wages that they have noticed is that the growth is at the lower end. The more senior employees are not getting increased wages as much as they were two years ago. The increases have leveled off. Also, the workers that age out normally or that would have already aged out are staying in jobs at the banks and with the banks' customers. They are not retiring at 64 or 65. They experienced retirement during the pandemic, and they are not anxious to retire. Employers are benefiting from that shift.

The Advisory Committee member said that finding replacements for employees who retire is challenging. There are not a lot of young people who want to work at a community bank that are skilled enough to do the jobs that retirement-age people have been doing for 20 or more years. Another Advisory Committee member asked Mr. Grantham whether data in any of the slides affected by stay-at-home work. He asked whether there is anything that can be said is a result of the number of people not going into the office to work. As a follow up, whether there is a stay-at-home option at banks and whether there is a difference in salary and benefits paid to staff who work from home or whether they paid the same amount. He asked whether the Advisory Committee members changed any compensation arrangements for those employees who came back to the office every day versus not at all. The Advisory Committee members said that they did not.

An Advisory Committee member said that his bank is on a schedule of requiring four days in the office and one day work at home and that works pretty well. He has noticed that employees have gotten accustomed to Zoom calls and online meetings. Even when staff are all in the office, they tend to continue to hold Zoom or team meetings. An Advisory Committee member said that he is not happy about that, but he thinks it is a piece of business that employers will have to deal with going forward. However, there are no differences in salary. Mr. Grantham noted that there is a big geographic component to variations in salary, but he is not sure how it impacts the available data.

He turned to slide 11 and said that it is a good graphic representation of what is happening to prices. He said that the inflation rate is the average increase in prices. That rate of growth has slowed. He said that is good but if the level of prices were looked at overall, as an index for the Federal Reserve's preferred measure, starting at January 2015 to about 2021, the rate of price growth is about one and a half percent below the Federal Reserve's target, then it expanded dramatically with the pandemic. At a certain point, the annual growth rate was over five percent for prices. Then, there was a decrease to a little over three percent, and now the level is at about two and a half percent. The rate of growth has slowed, but the overall price level has never come and will never come down.

He continued that price growth is at about 13 percent above the 2000 level, the pre-trend of one and a half percent growth. Today's price levels are still elevated, and that the current two and a half percent growth is on those elevated levels. He said that to make the point that the effects are cumulative, and this is probably weighing on consumers' perceptions of the economy and how they are feeling about it.

Mr. Grantham said that the University of Michigan survey, which is probably the most famous and has the longest time series is the data shown on the 12th slide. Despite very robust GDP growth, higher incomes, all-time records for home equity, net worth in terms of stock prices, the share of households reporting that their financial situation is worse today than a year ago is closer to recessionary levels. This chart goes back to 1978 and about 42 percent of households today say they are worse off today than a year ago.

That level is very high, and the follow-up survey question is what are the main reasons for the levels? It is not limited to one answer. The people who respond to the survey may respond to several, but the one that jumps out the most is prices are higher.

He said that 42 percent of the people who respond say prices are one of the primary reasons their financial situation is worse today than a year ago. That tracks very closely to the early 1980s, when there was an explosive inflation rate. Despite a lot of the positives on the economy, inflation, remains very elevated, particularly compared to where it was pre-pandemic. That is weighing on consumers' view of the overall economy, despite a lot of the positives.

An Advisory Committee member commented that the increase in prices can be seen in the grocery store. Even the candy bar rack shows higher prices, for example paying $2.50 for a candy bar. He said that not very long ago the same products were $0.50 or $0.75. Even those products are not affordable. He said that is his simple response to how hard it is to measure inflation. The types of products and services people buy varies by individual. Depending on what they buy and where they are geographically located, the personal experience of inflation can be very different than the headline numbers that are published.

Mr. Grantham said that levels of prices of food are higher than the core numbers. For consumers that are lower income, the greater share of their income goes to food and energy. It is weighing on them.

An Advisory Committee member said that his market has recently been through the devastation brought by Hurricanes Helene and Milton. He described that there is a blue tarp on every house. The prices of the supplies needed to make repairs have risen. Many of the homeowners will have to rebuild their homes and there is a shortage of building supplies because of wind damage to the trees used for lumber. He asked whether the increases in building supply and lumber costs will have an effect on any of the economic predictions.

Mr. Grantham replied that the price and availability of building materials could be impacted quite severely. In terms of individual economies, one of the best comparisons probably would be the impact of Hurricane Katrina. Surprisingly, growth after the hurricane was stronger than it was before the storm. The rationale was that a lot of federal aid pumped into the community spurred some economic growth. He said that he hopes that there is a similar scenario in the Carolinas and Georgia.

The Advisory Committee member reported that he had talked to people who were south of Tampa and there was 12 feet of sand on top of the roads by the beach and a foot or more of sand in the houses. He said there is concern about insurance in that geographic area because the insurance companies did take a hit on the storm damage. Southern Georgia just came out of a state of emergency the end of last week and there are still trees all over houses. There are other parts of the south similarly affected.

Mr. Grantham said that there have been very large contributions to the headline inflation number from both car and homeowners' insurance. These storms are going to hit the bottom line of insurance companies and that is going to result in higher premiums probably across the country over the next year or two.

He said that the magnitude will be interesting. In Florida, either home prices are growing less quickly than they had been because of the increased cost of homeownership when the cost of homeowners insurance is factored in. That is an area being talked and thought about. It presents an additional challenge to first time homebuyers. It is just one more factor to layer on an already expensive proposition.

Mr. Grantham turned to slide 13 and said that what the Advisory Committee members had been discussing relates to interest rates and what the Federal Reserve has done and will do. He said that in looking at the 10-year treasury yield, as well as the three-month Treasury bill. The three-month Treasury bill is one- to- one impacted by the Fed Funds rate that the Federal Reserve controls. He said that there has been a normalization of the yield curve, or at least getting closer to a term premium.

He said that the expectation in looking at the blue-chip forecast over the next 18 months, is for the three months, the 10-year spread to normalize and become uninverted, which would be positive. This cycle has been unusual, having the 10-year Treasury increase after a 50-basis point cut. Looking at history, it is very unusual.

It is making homeownership more difficult if the perspective is of where the economy is going over the next few of quarters and how this cycle relates to past cycles. A good representation is on slide 14, where the different Federal Reserve rate cuts can be compared across time. The 50-basis point cut was a little bit surprising. But if it is compared with the trajectory or the size and magnitude and timing of other Federal Reserve rate cuts, they can be very large and they can occur relatively quickly. Now is only two or three quarters in, about 50 basis points down. The starting at a level of five percent, which is more within a historical average level.

For purposes of comparison, there was less room to cut in 1984 or even in 1989, 2007 is probably the closest representation the Federal Reserve cuts about 500 basis points over about 15 months. The bond markets may give an indication of how much the Federal Reserve may make cuts and when,

The forecast projections can provide insight. On slide 15, the chart breaks down what the bond market is projecting in terms of the implied future Fed Funds rate over the next year, year and a half. The red dotted line on the slide shows the most recent data from October 2024.

The projection is that the Fed Funds rate would reach a little below 3.5 percent by the end of 2025 consistent with cutting going forward. In comparing it with previous estimates, the projected rate cuts are estimated and expected to be more aggressive, getting down to close to three percent much more quickly.

The bond market is not always a great indicator for what will happen in the future, but it is useful to see where money is being applied or where people think rates will go. He said that no one expected a 50 basis points cut as the first cut. Only about 14 percent of the blue-chip respondents were expecting 50 basis points.

The majority thought the Federal Reserve would cut 25 basis points and consistently proceed at that pace as the data came in. He said that it will be fascinating where it will go going forward. There have been a lot of speeches from FOMC participants over the last couple of weeks.

There has been a strong revision to data that indicates the economy is stronger than what was thought a few weeks ago. Some of the more hawkish members of the FOMC have come out and said that a pause may be in order as additional data comes in. He said that it will be interesting to see where the Fed funds rate goes, particularly at the next FOMC meeting.

Mr. Grantham said that because the data has come in stronger than anticipated, it is uncertain what changes will be made. With today's Fed Funds rate of below five percent, the economy does not look like it is slowing. Some of that could be the amount of government stimulus that continues to have running large budget deficit.

Slide 16 shows the economists' view and how they think and forecast inflation and particularly interest rates. Looking at the long view of the Fed Funds rate and where the blue-chip consensus has forecasted that it will be. He said that all of the little squiggly lines on this chart indicate what the blue-chip was forecasting in that time period. They do not do a good job of capturing what actually happens in the market. This is not a great representation of the economics field or the discussion so far. It is an indication of how difficult it is to forecast, particularly for interest rates. The expectation will be for continued cutting, but there have been calls for that.

Mr. Grantham asked the Advisory Committee members how many of them thought the Federal Reserve would cut rates at the next meeting or the meeting after that. He asked whether there had been any increase in activity when rates were lowered 50 basis points. An

Advisory Committee member said that his bank had seen some increased activity, particularly on the commercial side, but he was not sure whether it was driven by the 50 basis point rate cuts. The mortgage business seems to be increasing, but not at the pace that the commercial lending business is.

He said that he thought the cause was market disruption combined with some good opportunities. He did not think it was tied to the rate cut. Mr. Smith asked the Advisory Committee member about the increase in commercial lending and whether it was mostly refinancings, or new loan acquisitions. The Advisory Committee member replied that is increase was with new deals. He said that the bank started its commercial lending program about four and a half years ago and the recent increase may be due to a combination of being in the right place at the right time and getting more name recognition for the bank.

He said that the bank had hired some new bankers and gone into new markets over the last three years and that the moves had started to pay dividends. Another Advisory Committee member reported that his bank was seeing some turnover in the short-term balloon commercial loans that they were issuing at a four percent rate five years ago. The loans are coming back up to about seven and a half percent.

He noted that the trend may continue, and he said that he was surprised not to see the deposit markets be affected more by the rate drop. He said that CD rates are still very strong, and, in his market, the hot money market is booming, but it could be a result of competition in the New York city market, which is his geographic area. But banks, credit unions and larger regional banks are competing for deposit dollars. Advisory Committee members reported that in their markets credit unions are driving up CD rates.

An Advisory Committee member said that he thought that a rate cut was baked in and that consumers expected it. Borrowers are getting rates of seven and a half to eight percent. When rates reach six and a half percent to seven, that is not low enough for them to get a loan because they are expecting rates to be four percent again. Borrowers may wait another year or two. He said that he does not think that a six and a half percent rate is enough enticement for them. He said that he thinks that most borrowers are waiting for the results of the election.

An Advisory Committee member agreed that borrowers have been waiting for rates to come down for a while and they cannot wait any longer. Maybe the rates will not come down as much as borrowers anticipated and they realized how off the predictions were that rates would go down as much earlier than they did. The 50-basis point rate cut was more than was expected, but the optimism did not last very long.

An Advisory Committee member asked what the 20-year average is of the 30-year mortgage rate and what is the 30-year mortgage rate now. Mr. Smith said that he thinks it is as low as five percent and he noted that something to keep in mind, is the pricing for a 30-year conventional loan is very different from the pricing of short or tenured notes. So, the expectations for rate cuts may be that they may be timed to coincide with some triggers.

Mr. Grantham turned to slide 17, to discuss whether the noninterest income (NIM) at community banks, usually declines after the Federal Reserve starts cutting rates. He said that the actual data, over a longer time period, show that it is more the spread of the yield curve determining NIM. But in the short term, Federal Reserve rate cuts have had a negative impact on NIMs, because of the assets repricing faster than deposits. In reviewing past cycles, outside of the 1989 to 1992 cycle, there was a severe impact on NIMs when the Federal Reserve started cutting rates. He said that he would talk about why the 1990, 1989 piece was a little bit different. But generally, once the Federal Reserve starts cutting rates, there is a compression in community bank NIMs.

He said that the Advisory Committee members' books of business might be slightly different because they are more focused on residential lending and have less repricing on the asset side. He asked whether they had seen a compression on NIMs from the change in Fed Funds rates or whether it was the compression that was mentioned earlier? An Advisory Committee member said that his situation is unique. He said that they modeled as rates start to come down the first six months. He said that they see compression, but that they pick it up tremendously in the following six months. While their cost of funds has increased, the asset yield has gone up.

Another Advisory Committee said that he thinks that the market is entering into the compression cycle, as opposed to having already been in it. He thinks that it is at its peak right now, and there will be compression as rates continue to come down.

Mr. Grantham turned to Slide 18 and explained that 1990 is different. Looking at community banks with under a billion dollars in assets, he noted the difference between the bottom quartile for NIM change and the top quartile. One group saw their NIM compress about 90 basis points. The other group on the top end saw their NIM improve quite a bit. The difference here is based on asset composition and what was happening in the loan book.

He said that the distinction with the loan book for the top quartile was less repricing than what is evident at the bottom. Mr. Moloney added that there was a regional component to the difference. Some banks in the northeast were under more stress and in Texas, they were likely to be in the bottom quartile. But there is some credit stress embedded in the bottom quartile group. He said that those banks that benefited the most were able to take advantage of the rate cuts much more than their peers. There was some regional differentiation that should be noted, and he added that normally when there are downward rate cycles, they correspond with recessions. He said that this time period is a little bit different.

Mr. Grantham turned to a discussion of what happens to the loan book, at least historically, when the Federal Reserve begins the easing cycle, and he turned to Slide 19. Community banks with less than $10 billion in assets are on the left and the larger banks with over $10 billion in assets are on the right.

Each of these cycles is different, as the Federal Reserve starts cutting rates when the economy is in a recession and contracts, there is quite a difference across the cycles in terms of loan growth overall. In the 1984 cycle, there was robust loan growth the three years prior to the beginning of the Fed Funds rate cuts. When the Federal Reserve started to cut rates, the typical use of the rate cuts has been modest to very slow loan growth. This time, with the economy growing, it is hard to say what will be the result. One of the challenges in the current cycle will be in looking at the weighted average interest rate that a current borrower has been locked into, low fixed rates, lowering 50 basis points, 100 basis points, maybe even 150 basis points. Particularly on the mortgage side, there will be a big difference in refinancings.

He said that in terms of the loan growth on the residential side, it might be stagnant unless rates come down dramatically. On the commercial side, the Advisory Committee members have indicated that they are starting to see an increase in loan growth, although some of it might be more business related. Mr. Grantham asked whether any of the Advisory Committee members was seeing growth on the commercial side.

An Advisory Committee member said that in his market there is growth now. His community is between larger cities and the larger banks with branches are placing commercial loan officers in the town. He said that his commercial loan officer is sitting on business. He said that loan officers from the large banks try to work remotely in his community, but it does not work the same as being in person. His bank will make loans that larger banks do not look at.

An Advisory Committee member said that his bank is benefiting from the growth of his community, and the bank has had more opportunity than it has previously had. Businesses are coming in and that creates some pickup. He also said that he is seeing something that he has seen in his commercial lending days, a couple of the super-regional banks are telling their customers that they have to reduce their commercial real estate portfolios. The result is that the smaller customers of those banks have reached out and asked whether his bank wants their business.

An Advisory Committee member said that lot of his competition in the area has priced themselves out of the market for the time being. They effectively throttle their loan production on the commercial side just by creating rates that are uncompetitive, just because of liquidity issues, because of concentrations, and simply because of a rate. They have got to pay their depositors at such a high rate and now that interest rates are coming down, they cannot set the rates high enough for what they need to do in the short term. They are sitting on the sidelines with cash. They also had a lot of borrowings. Unlike most of the community banks or mutuals across the country, the larger banks have so many borrowings that increase their cost of funds, because the borrowings occurred during the higher interest rate cycles.

He said they were long-term borrowings from before rates were low. They are busy paying those down. He also said that in his area FDIC examiners have looked at liquidity and brokered deposits and other ways to raise funds negatively and that creates a hesitation or a fear in putting that money to work in the marketplace in the form of commercial loans.

Mr. Grantham turned to slide 21 and said that it shows community banks versus the overall system for residential real estate growth through easing cycles. He noted that other than the real estate expansion that occurred in the refinance boom of 2003, residential real estate lending, at least on book, was relatively flat and modest in easing cycles historically for community banks. He said that he thinks that is what is happening now. He said that there are a lot of unique factors in the current market that are limiting activity.

He turned to slide 22 to summarize the presentation and wrap up the discussion. He said that he had talked about a number of areas and appreciated the feedback and comments. The discussion gives his group additional ideas about things to look at. A takeaway is that economic growth remains resilient and that has surprised a lot of forecasters and economists. The expectation is for it to moderate, but every forecast horizon that he showed in the presentation showed the out-of-sampling results have not been good.

He said that typically, growing economies do not die of old age. Usually there is an exogenous shock that causes a downturn. Those tend to be unreliable and hard to predict. There has been an easing in the labor market, but he does not think it is at the point where it is concerning. It is closer to being more imbalanced than at any point it has been over the last five to seven years. The overall employment rate remains historically low.

He said that hiring is at fairly elevated levels and that the question begins, what happens with inflation going forward? Has the economy turned the corner sufficiently? Will the Federal Reserve continue to cut rates as they indicated with the last press conference? Mr. Grantham said that some of the challenges will be that after revisions to the data, it may come back more strongly than what was thought at the time. As additional readings come into the labor market, there may be weaknesses start to bubble up. He said that he thinks the Federal Reserve will cut more aggressively, but there is a chance they begin to pause and wait to see as more data come in.

An Advisory Committee member asked a question about the Federal Reserve looking at the rate cuts and these considerations. He said that his bank is starting to see in the press what the long-term effects of the ballooning deficit is going to be. They seem to be moderating inflation, but everything the government has been doing from a spending standpoint has been in the exact opposite direction, which is unusual in this particular environment.

He said that it is a tough question and what are long-term effects of that? Is it going to have any effect on the Federal Reserve choosing what to do? He said that it is exacerbated by the weather events that have occurred and the money that is going to be pumped into the economy. It just seems like the spending is unsustainable, and he asked whether that will have any effect on the interest rate market. Mr. Grantham said that is a great question and he clarified that his comments reflect his own personal views, not those of the agency or the Treasury Department.

Mr. Grantham said that it is it is very unusual. Typically, large budget deficits occur in a weak economy. Having budget deficits of five to six percent when unemployment is below five percent is very unusual. The concerning aspect is the relative size today, so 120 percent debt to U.S. GDP is at a level that last existed in World War II. The trajectory going forward is based on the Congressional Budget Office information, which is nonpartisan, is that budget deficits are not expected to get under control for the near future.

Typically, basic level economics would suggest that budget deficits at five to six percent in perpetuity are inflationary. He thinks that Chairman Powell has referenced that, that they would like some help on the fiscal side, but it does not appear they are going to be getting it. he said that he thinks that it is going to make it more challenging to get to that two percent target. It is hard to say what that means for interest rates. He said that one theory is the crowding out effect where there are continual budget deficits.

More Treasuries are coming into market and pushing up interest rates, they crowd out private credit and could slow the economy down in the future. There are other branches of economics that suggest budget deficits do not matter. That is more in the minority.

He said that he is more concerned is that the economic position is healthy, but having deficits of this size in perpetuity is concerning, particularly at the 120 percent to GDP ratio. Looking at Japan and they are at 200 percent to 300 percent GDP to debt ratio. Their interest rates are lower. They have not had a catastrophe, but they have been growing more slowly than they were in the 80's and 70's. Overall, the general thought is negative for GDP growth, but a growing economy can solve a lot of issues. If GDP growth and productivity can grow faster than debt is growing, the economy can get out of this. It remains to be seen whether it can do that.

Mr. Knott added to that point. He said that Federal Reserve Chairman Powell, at his last news conference, said the era of free money is over. Mr. Knott thinks the budget deficits are one factor, green initiatives and spending, looking at the Federal Reserve's dot plot, the last one from the September meeting, they bumped up that rate from 2.8 to 2.9 percent. Experts like Larry Summers are out there thinking that the economy can be near a forehandle, but he thinks the consensus is that it is going to go back to that era. He thinks that rates, when they settle down after the cutting is over, might be closer to three percent or three and a half percent.

He said that it is a good point because if we do not get the fiscal house in order, either by raising taxes or cutting spending, he does not think either party wants to do that right now. There will be elevated and more to come on that. Mr. Grantham conclude the economic presentation.

Mortgage Update and Roundtable

The Advisory Committee meeting was called to order after a short break. The next agenda item was a Mortgage Update and Roundtable that was led by Joe Smith, a Technical Mortgage Expert in the OCC's Credit Risk group in Bank Supervision Policy. He was joined by Natalie Tiernan, a Lead Modeling Expert in the Retail Credit area of the Supervision Risk and Analysis Division. The Advisory Committee members were sent a list of mortgage-related questions and topics in advance of the meeting. The questions are attached to the minutes. In addition to the questions sent by the OCC, an Advisory Committee member submitted a question that will be addressed as part of the discussion. That question is described below as part of the discussion. Mr. Smith welcomed the members of the Advisory Committee and said that hearing what is going on in the mortgage market at the ground level is extraordinarily beneficial. It helps OCC staff assess the risks on a quarterly and annual basis. He noted that his group works closely with Mr. Grantham and Ms. Tiernan on a quarterly basis to prepare for the National Retail Risk Committee meeting. There is a constant interchange between the groups that use the economics data and the information and research that the Supervision and Risk Analysis group creates. It is useful to the viability of the agency's assessment of risk going forward. That assessment is used to brief the OCC's Executive Committee and others.

Mr. Smith said that one of the bigger issues in mortgage banking is ability to repay and getting into homes. The Mortgage Purchase Application Index and the Refi Application Indices are currently showing the lowest numbers in a long time. There is constant pressure to try and find ways to get people into homes. He asked how it can be done in a manner that is consistent with the expectations that that lenders have while protecting consumers in the community and promoting homeownership.

From a retail credit policy perspective, he said that retail credit market is stable. He did not talk about credit cards and auto lending. He said that from 2005 to the fourth quarter of 2023 in the mortgage portfolio, weighted average loan-to-value ratios in 2005 was 68 percent.

Today, it is 67 percent. Debt to income was 19 percent and is 20 percent now. But for jumbo loans, it increased from 21 percent to 47 percent and loans with balloon payments, option arms and interest-only arms are greatly reduced.

Mr. Smith said that the profile is mostly long-term fixed-rate mortgages and although 27 percent are ARMs, most of those are hybrid loans or they are the standard one-year, three-year, five-year ARMs. The percentage of the prime portfolio moved from 43 percent to 82 percent. He said that is a big over a 20-year period. The performance has been the best on a national bank level in 20 years. In 2005, 2.3 percent were 30-day delinquent, and it is 1.1 percent now. He that much of that has to do with the work that mortgage lenders are doing in their institutions.

Mr. Smith asked the Advisory Committee member who sent in the question to describe the issue he raised. The Advisory Committee said that one of the issues that has come to his bank management's attention is how FHFA is looking at data and revamping the long-time credit scoring process.

He said that while the lending industry supports the efforts to expand credit to qualify more borrowers, there has been very little information from the FHFA and the GSEs. The lack of information creates uncertainties about timing and data quality and indicates a delay in an early resolution for the issues may drive lenders from the market and create harmful outcomes for all borrowers.

He said that the credit score transition and change is expected to go into effect in the fourth quarter of 2025. In June 2024, VantageScore released historical credit data, but it does not include historical data performance during a declining economic cycle. The credit reporting data for FICO 10T, a new credit score model has yet to be released. The GSEs will be increasing the total number of credit reports required to be pulled from three per borrower to four to six per borrower, with the result that costs will be significantly increased for borrowers. Additionally, FHA, VA and USDA have not indicated adoption of these new credit scoring models, creating new bi-furcated approaches to qualifying borrowers.

He said that the planned credit score transitions affect underwriting policies, pricing grids, risk management compliance and likely will require historical back testing and fair lending analysis, to align with safety and soundness risk analysis requirements by the prudential regulators. H argued that it is critical that FHFA and the prudential regulators understand and consider the broader implications and potential negative impacts on the pricing of mortgage credit if industry stakeholders are unable to obtain the data necessary to complete their analysis. He said that he is also concerned that many small and mid-sized community banks, including mutuals, do not have the capacity to perform full data analysis on the new credit score data.

He said that the industry is at a standstill on being able to implement these programmatic changes and is looking for the OCC, FDIC and the Federal Reserve to speak to the broad impact to the housing market as well as community banks to continue lending to their communities.

He noted the importance of credit scores to the safety and soundness of the industry, as well as of smaller lenders to continue to engage in mortgage lending. He asked whether the OCC is engaged with FHFA to make sure that the contemplated changes are being well coordinated and will not lead to unintended consequences. He also said that bankers want to be prepared to be able to answer any questions from the regulators as they come in to do the examinations. He said that he would ask the Acting Comptroller whether there would be a transition or coordination, whether the FHFA is coordinating with the primary regulators to address some of the concerns that the banks are going to be having.

He also said that he is concerned about how the banks would be able to answer questions from consumers when new opportunities come up or there is no ability to fund some of the mortgage requests. He said that the bottom line is that it is going to affect consumers. He asked whether there is any insight about OCC working with the FHFA or whether there is a plan to issue guidance to banks.

Ms. Tiernan introduced herself. She is a Lead Modeling Expert in the OCC's Retail Credit Risk Analysis Division. She said that her team serves as technical advisors for the OCC on issues of model risk management and her specialty is in retail credit. She said that her group understands that this is a big transition, and it is going to impact every institution that delivers loans to Fannie Mae and Freddie Mac. It is also going to impact all institutions that decide to take the opportunity to transition their own internal models at the same time that this transition takes place. It is going to be a big undertaking.

The most recent information that the OCC has indicates that the GSEs anticipate a complete transition by the end of the fourth quarter of 2025. They are still trying to gather the necessary data needed to test the scores. She said that she believes that the industry will hear more from them on that in the future. But as part of this transition, she suggested that institutions be versed in the guidance that is going to be helpful in this case. The Interagency Third-Party Risk Management Guidance and the Interagency Model Risk Management Guidance are very good sources of information on how to handle this transition. The relevant OCC Bulletins are 2023-17 for the Third-Party Risk Management and 2011-12 for the Model Risk Management Guidance.

She said that at a high level, institutions will need to transition to new FICO 10T Advantage Score 4.0. Banks will have to incorporate them into their broader model risk management frameworks which follow the same principles the bank has for in-house models, if they are hosted. The process will be modified because these are vendor models and banks will have all the information that they would have they developed the models in-house.

She said that the vendors, FICO and Advantage Score, are going to have to provide banks with the information explaining the model components, the design, and the intended use of the scores. They will also have to provide any testing they have on how the models perform and show that their product works as expected. They also have to provide information regarding the key assumptions of the model so that the bank can assess the assumptions and any limitations that they have identified.

All of this information can be gathered in a development document, for the bank's reference that lists everything that the model vendors provide to the bank so that they can all have an understanding of what the model contains. The next step is going to be validating the model, or both models. This will include a review of the conceptual soundness of the models.

Does the data make sense in the models? She said that it probably does, but banks will have to think about that these models were developed on a nationwide population and decide whether they are relevant the bank's business. Does the bank have a target in a certain geographic market? Does the bank at consumers in a certain score range instead of the broad score range that would be included in the score development.

She said that the bank would need to look at model performance for how the bank will use the model and external models are not going to have all the information that the bank would have if they had developed the model in-house. The bank may have to rely on comparing the model's performance to something known, which is the classic FICO score.

Smaller institutions may also look to vendors to help them with this validation process. In that case someone in the bank should be able to understand kind of the outcome of the validation process and take identified risk management actions that the validators call out. Importantly, all of these things involved with the transition need to be commensurate with the level of risk posed by the model's use at the bank.

Ms. Tiernan sad that the appropriate model risk management activities would differ for each bank, depending on how the bank uses the model and whether it is material for the bank. It also is going to depend on whether the bank uses it for a held for sale purpose or are all of the loans that are booked going straight to the GSEs or whether the bank is a portfolio lender. She said because if the bank portfolios those loans, there is additional credit risk. She asked whether are other areas in which the Advisory Committee members' banks would be adopting the credit scores in order to get into the more nuanced details that they may need to consider.

Ms. Tiernan asked whether any Advisory Committee members would be adopting the scores for use in portfolio lending and at what stage the banks are in the credit score transition so far. The Advisory Committee member said that as a portfolio lender who does not sell to the GSEs, the bank's modeling has always been a little bit different than what is provided for with FICO scoring. He said that the concerns he has are the effects on the borrowers. He said that what his bank is doing right now gives a fuller picture of what the credit score shows, but also the ability to repay and the debt service that borrowers are accumulating as they come to the bank for a new loan. But the new reports that are going to have to be pulled are going to result in an increased cost to the borrower.

He said that is a real concern. The bank pulls three reports, and it passes along the costs to the borrower. The costs of those reports have gone up dramatically since the pandemic. With the number of reports increasing to four to six being pulled for every borrower who is on the loan application, he thinks there will be tremendous pushback. In many cases, as community lenders, the banks will absorb some of those costs. He said that he had brought up the question with his board of whether the bank would be able to pass along those increases, or whether the banks should start to absorb some of the costs in the pricing models. He also said that there are bifurcations in different submarkets.

The Advisory Committee member said that the FHA, SBA and the USDA have not indicated whether they will adopt the new standards and there are some real issues going forward if these are supposed to be implemented by the end of 2025, which is an ambitious plan for such a dramatic change. He said that he had been to FHFA open house discussions and roundtable discussions on what are the plans for Federal Home Loan Bank changes. He said that he does not see a lot of interaction with the community banks on this.

Mr. Smith asked whether the other Advisory Committee members have any other concerns about this. An Advisory Committee member said that he also has concerns, and his bank staff is exploring what the implications for his bank. Another Advisory Committee member said that he was not necessarily concerned but that he hopes that credit scores become more reflective of overall credit histories, because he thinks that over time the models have weighted different events in a consumer's past.

He said that it has gotten a little bit out of whack, and he hopes that moving forward the scores reflect the actual history better. Mr. Smith asked him where he thinks the scores may have gotten a little off balance and he replied that he is not really sure, but he feels that certain things have been weighted aggressively, for example, the medical collection accounts seem to skew a consumer's score much more than they should. The fact that it is getting attention, and he is hopeful that some things may be improved going forward.

Another Advisory Committee member said that his bank is a little smaller than most represented, and they tend to hold on changes until they have been implemented before they react. He said that he agrees that the medical side over influences the result.

Another Advisory Committee said that the change does not have much effect on his bank because their model is more of a commercial lender than a residential lender. The credit scoring is more for the loan guarantors on the commercial side. Another Advisory Committee member reported that he listened to a webinar hosted by his state's banking trade association and because his background is not mortgage lending, he was caught off guard. He said that he thinks there are many tentacles and opportunities for unintended consequences. He thinks that implementing the change 12 months from now is just fraught with error.

He also thinks that the change will impact the affordability of homes. Bankers keep talking about affordable housing, but the industry and the agencies put more obstacles in the way of affordable housing and this is another one.

Another Advisory Committee member said that he waiting to see what happens.
Another Advisory Committee member said that his bank is in the same situation as everybody else and agrees that it is an affordability issue.

Another Advisory Committee member said that currently his bank uses TriMerge which is basically using three different credit bureaus. But all three show different, low-high ranges for all three and his bank averages them out. He reiterated that he is a portfolio lender, and the bank absorbs a lot of those costs, just like the rest of the bankers in the room. He said that when his bank competes against the secondary market loans and secondary market lending, costs or changes to costs have an effect. He asked whether the system is broken and where can it be fixed?

As a follow-up, Ms. Tiernan asked any of the Advisory Committee members had seen any other financial institutions starting to adopt the Vantage Score 4.0 yet. She said that maybe there is some feedback that will help the Advisory Committee members prepare for it.

She said that she is aware that some lenders have used it. Vantage 4 has been in the market a while and that different banks have adopted that score for a variety of their portfolios. They have also seen it used for credit cards and auto lending portfolios. She said that in the mortgage space, a lot of lenders tend to use the classic FICO score just to leave their options open as to whether to deliver the loan to the GSEs or to keep them on their own books. The score transition is really the impetus for a lot of the larger institutions to move their mortgage lending operations over to the new scores because they are going to be doing it anyway.

Ms. Tiernan said that she has not seen FICO 10-T used as much in the industry yet, but that is probably because it is a newer score. She said that she thinks that a lot of the larger institutions have gotten a start on the transition based on information that FHFA has shared with the OCC. But she acknowledged that it is a big undertaking.

Ms. Tiernan said that if a bank has a portfolio of loans, it has internal reporting and MIS. The bank has to report a FICO score on the list and break down the portfolio by FICO score. Now there is a new FICO score and how will the bank transition all of that data. Banks are also looking at their CECL models or capital requirements models and now a 720 classic FICO is not the same as a 720 FICO 10-T and an adjustment has to be made to the other models that are used. It is a big undertaking and some of the larger institutions have gotten a jump on it.

She asked whether there are other questions. An Advisory Committee member asked how some of the non-financial lenders, for example Rocket Mortgage or the Loan Depot are addressing the change. He noted that Loan Depot advertised a lot during the baseball World Series, and he questioned the source of funds, but that they seem to be taking over the mortgage market and they sell to the GSEs. He said that as mutual bankers, they tend to wait to see what happens before implementing any kind of major changes, but that kind of data is critical.

Ms. Tiernan said that she does not have much insight into how the non-depository lenders operate but she thinks that they would have to be transitioning as well. She also thinks that institutions they are working are delivering loans to them and would require some sort of testing or the models and management type of activities. She said that she thinks they will be expected to comply with the expectations of the GSEs at the end of the day.

Mr. Smith noted that the non-depository lenders would have to have to deliver to their seller servicer guide. It is pretty straightforward. He said the question would become whether grandfathering of the older scores would be permitted or whether the newer score requirements and methodologies would be required.

He said there is usually a 90- to 120-day grandfathering period so that the lenders can clear their pipelines and they can get the newer product through. They do not have the same type of credit risk management practices that OCC supervised national banks and thrifts do because they are work with an originate-to-distribute model. They may have some delinquency or loss modeling forecasting for collection purposes that banks use credit scores with.

He said that he does not think that they look with the same depth associated with credit scoring methodologies. For example, when capital reserve methodologies are discussed, they types will use a FICO score. It is more complicated for insured depository lenders than for a non-depository lender.

Mr. Smith asked Ms. Tiernan if she had other points to make. She noted that one thing that had been brought up as part of the Advisory Member’s question was the data needed to test the new scores. The FHFA has put out the Vantage score historical data so that institutions can start comparing and contrasting what kinds of scores consumers were getting from the classic FICO versus what kinds of scores they are getting from the new FICO and new Vantage scores. The FHFA is still waiting on that data for the FICO 10T score. She said to stay tuned on that. She thinks to the extent this is something that the banks will need to do, they can start to look at the Vantage score data that has been provided to at least get a start. The back testing piece is going to be an important component of understanding how the model is going to work and changing lending strategies appropriately to meet the same risk tolerance banks had in the past.

Mr. Smith said he would transition the discussion to insurance and other topics if there were no other questions. He said that as OCC staff work on an interagency basis that sometimes OCC staff are not brought in on issues until later on or in parts. In deference to the process, sometimes staff does not have information that would be as fulsome as they would like. Sometimes there are limits on what other agencies can share or other sensitivities as well. Guidance may be issued that will provide better insight into the various places where credit risk, credit model, credit scores are being used.

An Advisory Committee member noted that with such a major change in a big part of the market, there seems to be a catch there that could be into the realm of CFPB because the impact on the consumer. The bottom line is that it is the consumer who will have to pay for all these changes and that is when the CFPB usually steps in and asks about the fees. With FHFA working on something and the prudential regulators look at this from the regulatory side, bankers do not want to get caught in a trap because this has potential.

Mr. Smith said that OCC staff have no insights as to the conversations FHFA may or may not be having with the CFPB. The Acting Comptroller may not have any insight either. The Advisory Committee member said he would ask the Acting Comptroller when he comes to the meeting.

Mr. Smith asked the Advisory Committee members for a general sense what is going on in their marketplace in terms of marketing times and product types that are available. He also said that the Advisory Committee members have brought up the issue of first-time home ownership and that is something that is important to everyone. He asked what the Advisory Committee members are seeing in their respective areas with respect to first-time home ownership and what are the impediments. He noted that limited supply is a given.

He provided a synopsis of the housing market in Northern Virginia. If a house is priced at a certain level, it is gone in 48 hours. It will disappear. People are buying off the Internet still in certain markets at certain price points. The average price is higher than $400,000 and first-time home buyers, depending upon how close they are to the city, may have to pay $500,000 or over for a modest townhouse with about 1.600 square feet that is in a neighborhood located about 35 miles from Washington. He said that in Northern Virginia, D.C., the DMV area, the higher-priced tiers, above $1,000,000 is middle-class in this area, marketing times are getting extended. One of the reasons is the interest rates.

An Advisory Committee member said that in looking at the cost of housing throughout the country he is glad he is in the Midwest. The pricing in California and the East Coast is higher than his market. If the rates for 30-year fixed-rate mortgages declines, he thinks his portfolio will refinance into 15- or 30-year mortgages, he sells to the Federal Home Loan Bank. He said his bank participates in some payment programs, for example, programs for first-time home buyers for professionals, heroes of the community, firefighters, and police. He said even in the Midwest with low prices, they are still high. In urban areas bidding awards are still standard here at certain price points.

An Advisory Committee member who is located in South Georgia, an area recently hit by two hurricanes is processing thousands of dollars' worth of insurance checks, and the bank has to handle them in a loans-in-process accounts to make sure the work is being done to the houses. The housing market has slowed down from what it was 14 or 15 months ago. The pricing sweet spot in the market is in the $150,000 to $225,000 range. There are houses that are above $500,000 that are selling, but not as many as there were a year ago. The two recent hurricanes are creating another influx of people from South Florida moving to South Georgia, so they can be close to family. This is the closest place to Florida that they can get to. It likely will take at least six months to settle down.

An Advisory Committee member said that there is a group working with state trade organizations and mutual groups to contribute to any type of natural disaster relief funding in the areas hit by the hurricanes. Mutuals Matters is a trade group association that is going to concentrate the needs of mutuals.

An Advisory Committee member described how a great many groups from across the country have come in to help his community. He said that it has been interesting to watch just a sea of people with chainsaws and that not doing it for profit. There are a lot of people in the area that had trees came through their houses and they did not have insurance, and they have no way to rebuild their homes. There are a lot of groups that are coming here and helping to rebuild. FEMA just came on site this week, but they will be there for five days. Hopefully they can help some people with their projects.

An Advisory Committee from the New York metropolitan area talked about the market in his area. The supply is incredibly short right now, and his bank is seeing the same type of effects that are being seen the Midwest. Houses are being turned over in just a matter of days. He described the gentrification of his suburban neighborhood, where there are a lot more baby carriages and young families buying homes. He said it is frightening the debt that many of these young families are taking on with a 30-year mortgage.

The pricing in New York right now in a starter homes are well above $800,000. First-time homebuyers are buying co-ops and condos. The co-op market in New York is unique because they are on leased land, and the land leases are coming due. These leases are 50- to 100-year leases, and the prices are so far behind mortgage trends that HOAs and co-op boards are looking at anywhere from 500 to 1,000 times increase on what those land leases are going to be. The assessments to these new co-op owners could force them out of their homes.

There are a lot of different trends that are happening in the metropolitan areas that are going to be affecting how the first-time homebuyers are going to enter the market. New York is incredibly strong and without any solution from the city on what type of zoning changes it going to make, many of the developers are in holding patterns. There are infill housing opportunities and vacant lots that are still waiting for some sort of development, but there is no conclusion on what type of tax breaks that will be available. Generally, the housing market is so expensive that younger families or first-time borrowers are moving to Connecticut or New Jersey. He then described the rental market in the area and how hard it is to transition to homeownership.

Another Advisory Committee said that his bank is growing and is the second or third largest home lender in the Knoxville, Tennessee market. The city ranks as one of the least affordable cities relative to the income and the cost of a house. It is a little less than $400,000 for a starter home, but relative to the income of most people, it is hard to afford that cost. He said that his bank works with several nonprofits that help some first-time home buyers. The city has some benefits that can get a person in with a forgivable second mortgage for five years. The bank works as closely as they can with that, but it does not tap anywhere near the amount of market that it should. The market is robust.

He said that several of the largest builders in town talk about the fact that the politics of adjacent cities and counties talk a good talk about infill and higher concentration homes per acre, but the realities are when it gets down to it, the entities get political pressure from their constituents and back off those ideas and it is not being done. That is what is needed to bring down the cost is more concentrated homes per acre.

An Advisory Member said that he is located in New England and that there is no inventory, which is driving extremely low volume. His bank is doing 10 to 15 percent of the volume that it was doing three years ago in the residential mortgage lending area. When a house hits the market, it does not sit, and prices have stabilized, and the bank does not see any affordability issues. However, it is an extremely low sample size. He said that the market for junior lien lending for home improvement and commercial lending for new construction is showing the signs of starting to boom and is more than making up the gap. Residential lending based on inventory is extremely low, but the junior lien lending for home improvement and new construction lending on the commercial side seems to be making up the gap.

An Advisory Committee in Ohio said that his market is very affordable when compared to St. Louis and New York. There are very nice homes for $400,000 to $500,000, but there are remote workers from the Columbus area that can buy twice the house and that drives that up pricing as well. There is not much inventory. Similar to New York, there are landlords that are replacing current residents with immigrants who are paying a much higher price because more of them live in the same home, and the community is starting to have homeless among former long-term residents that are being moved out, given short-term notice to get out because the houses have been purchased by an investment company out of New York City, California, or Minnesota.

He said that his bank gets requests for loans from companies out of whatever state to buy 20 or 30 houses because they know they can fill them. Last summer for a little while, the community was named, the hottest real estate market in the country by some publications. He said that he does not know the factors that went into determining that Springfield, Ohio was termed the hottest real estate market in the country. The factors included how long the house sat on the market, the percentage increase the price had gone up in the last year or two and other factors. They were not the higher priced.

Mr. Smith asked whether the sprawl effect that developed during the pandemic with respect to the telework is continuing with telework slowing and many corporations are pulling back. He asked how much the Advisory Committee members think that this will pull back in or re-concentrate the purchasing around more employment centers. He said that the term is changing but he is curious if it should be part of the conversation.

An Advisory Committee member said that prices in his market in the Metro New York area, in the Hudson Valley just north of New York, so far out of whack compared to even what was described in Northern Virginia. There are no starter homes in the particular area, especially where he lives in Westchester County. He said that lots are a million dollars before a house is built. New home buyers are going north and west for more affordable options.

He said that there is a dearth of apartments and townhouses in the area because towns are reluctant to approve them. There is not a lot of low-income housing. He said his bank does a lot of lending in areas closer to the metropolitan areas, but it does not do any residential lending. It does a fair amount of construction lending, both single-family homes and some other hotels and larger projects.

He said that the bank made a loan for the construction of a hotel in the Bronx and that when the construction was finished and the bank termed out the loan it was being operated as a hotel. Now it is 100 percent occupied as migrant housing with a lease signed by the city of New York, and that is happening in hotels all around New York City. But in the northern and western area where his bank is located prices are remaining at a high level, but not really going up anymore.

He said the marketing time is extended, and there is a lack of inventory because municipalities do not approve housing projects and the reluctance of builders that feel the profit is not there, especially in the current high-interest rate environment. Finally, borrowers who have mortgages with a three percent rate are reluctant to sell their homes and buy other ones. He said those are examples factors that result in the lockout effect.

An Advisory Committee member said that he agreed with what the Advisory Committee members had said but that he had a few other thoughts. He said that his bank is a 121-year-old mutual and that for 120 years the bank only held its loan in portfolio, and the borrowers were not eligible for down payment assistance through North Carolina Housing Finance Corporation, because the program requires an automated underwriting module. His bank does not use automatic underwriting, it underwrites to its own standards.

Consumers were disqualified from getting down payment assistance for their loans, at least through that agency, so the bank had to depend on city and county money. That has increased the problem a little bit. He said the other piece, and it was described in a recent guest essay written in the New York Times by two writers, one of whom is from Winston-Salem, and it is about how the mortgage industry unintentionally created the affordable housing crisis.

He said that when affordable housing is discussed, there are four or five segments of affordable housing. There is low- to moderate-income and there is workforce housing. He said that affordable housing in Brooklyn is a lot different than affordable housing in western North Carolina. The article speaks to how regulation intended to protect the consumer through the financial crisis has actually hurt the consumer that it was meant to protect, because at the cost of dealing with 400 different rules from Dodd-Frank and there are several more that we have got to deal with.

Banks have gotten out of get out of the business of small-dollar lending and the gentleman who runs the Center for the Study of Economic Mobility in Winston-Salem State talks about $150,000 homes and $150,000 mortgages, and they are still available. At least in Winston-Salem, North Carolina, a person can buy a $150,000 home, but can they find a lender to make the loan? Because if bankers are compensated on commission, and the amount of time and money that it takes to originate a $150,000 loan versus a $1.5 million loan, it takes about the same amount of time and money or perhaps it is harder to underwrite a $150,000 than it is a $1.5 million, the banking industry is out of small-dollar lending and that is unfortunate. One of the things that the Advisory Committee's bank is proud of is that the mortgage bankers are paid a straight salary, whether they make $100,000 loan or a million-dollar loan, they will get the same W-2 at the end of the year.

He adds that the New York Times article adds an interesting perspective to this small-dollar lending conundrum and how bankers figure out how to bring it back because what happens is the $150,000 homes, get pushed to an investor who is eight states away. That lender does not care about the maintenance, the tenant, or that the industry is taking owner-occupied homes and moving them to the investor market. He said that is not good for job creation in the community or its economic viability. It is certainly not good for economic mobility, given that housing is the largest source of intergenerational wealth transfer.

He said that his bank has started selling loans in the secondary market, which opens up down payment assistance. It opens up some more flexible debt-to-income requirements than the bank was willing to put on its books, which also helped. The bank now is a part of a local Winston-Salem Foundation that has created a task force to create an affordable housing fund.

He said it is early in the process, but they are thinking about how affordable housing is defined and what model of the fund should be created. He said even in a smaller city like Winston-Salem, there are 16,000 housing units fewer than needed. It is intriguing. They need to think about the affordable housing piece and a large piece of that is a small dollar lending component. Mr. Smith said that he had heard that perspective from many sources.

An Advisory Committee member from Louisiana reported that like everyone else, inventory is a big issue for his bank. His bank is not seeing many homes that are available in the middle of the market. They are either low- or moderate-income or they are upscale. He notes that upscale in his market may be $800,000 and above and those are the homes that are available. A lot of first-time homeowners cannot afford a million-dollar home. He said that they are seeing developers from outside of the market coming in and developing a whole neighborhood, doing all the financing, providing lots, doing all the building. They finance the home, which takes his bank out of the loop altogether, which then makes the bank try to be more competitive.

The Advisory Committee member said that because they have had a number of natural disasters, they found out when the bank's borrowers received their insurance check, it was made payable to them and the bank, they could come to his bank, and they could endorse it. If the loan was financed by Rocket Mortgage or another out of market lender and they did not have a branch or location in the bank's market, the borrowers had issues getting the check endorsed. The bank realized they could advertise the difference and highlight that it is a local community bank, and it can help borrowers in times of need.

He also said that in their community, developers have come in and buy a house and tear it down just to rebuild because they want to be in a particular neighborhood. He said that his bank also pays its mortgage lenders a straight salary and not on commission for the same reason that other Advisory Committee members have mentioned that they do. The dynamics are changing in some areas and communities are changing. He said that he had a home in

New Orleans when Hurricane Katrina hit, and a lot of people moved out of New Orleans, and they have not moved back. He said that they found that it has become a more affluent community and the residents who moved out cannot afford to move back. Also, consumers from outside the city bought the homes or rebuilt them and the original residents have been priced out of being able to afford the homes.

He said that insurance is hard to get. A lot of the insurance companies have pulled out of Louisiana completely. Either borrowers cannot get insurance or if they can get it, the prices are so high they cannot afford it. That is a huge issue for mortgage lenders in the area. The local bankers' association is working very hard within the state to get incentives for insurance companies to come back and get involved in the community so that mortgage lenders can work with homeowners to get affordable insurance.

Mr. Smith brought but a point with regard to affordability and first-time homeownership. He said that 83 percent of all FHA loans are first-time homebuyer loans. He said that he had heard and is trying to confirm that people are getting a private second trust behind a first FHA loan. It is piggyback. He saw a number in an article, and it has been confirmed that 18 percent of all first-time FHA borrowers are getting piggyback second trusts. That means 100 percent financing in an FHA loan. He did some research and found that FHA has what is called MRI, the minimum required investment, by a borrower. It is 97.5 percent. There are some exceptions where the borrowers can have 100 percent. Most of those are state programs. For example, the Virginia Housing Development Authority and there may be one in New York and North Carolina. Those are permissible exceptions, and the borrower does not lose the FHA credit guarantee.

He said that he does not know whether the FHA credit guarantee goes away if a private second trust is discovered to be in place, either at the time of origination or was contemplated for origination. He said that if the Advisory Committee members are doing FHA loans, they should be aware of the practice. He also said that the OCC is seeing a lot of bank statement loan programs again.

Bank statement loans are loans where the borrower takes the income off bank statements for the past 12 months, and then they apply an expense estimator to that particular business, depending on the type of business, and the range of the expense estimators vary wildly. Mr. Smith said that he had seen numbers as low as 25 percent for expenses to as high as 50 percent. He said that there are a million different ways that can go wrong when it comes to understanding the expenses for a particular borrower, potential disparate treatment, potential inaccuracies. As a matter of fact, in many of the situations reviewed more than 80 percent to 90 percent of the loans the debt-to-income ratio was inaccurate.

He turned to a discussion of homeowners insurance. He said that Mr. Grantham has done a lot of work on developments in the insurance area with the OCC's risk analysis group. Mr. Smith said that he wants to talk about insurance as part of the scope of total affordability of mortgages. He said that currently 90 percent of the housing market has fixed rate mortgages, but payments are continually going up, not just because of homeowners' insurance, but because of taxes.

Mr. Grantham provided some information from the National Mortgage Data Base, from which escrows can be pulled. The escrow number does not break out taxes and insurance. The Consensus Bureau conducts a survey that pulls county-level amounts of real estate tax paid for a given year. It is possible to look at county-specific data to back out how much taxes are contributing to increases within the county. The remainder can be broken out and it is possible to see what is coming from homeowners' insurance. The OCC is working diligently to get more specific data, but from what can be seen, in 2019, the average principle, interest, taxes and insurance was $1,249 and in 2024 it is $1,482.

The percentage of the total increase allocated to insurance is approximately 48- to- 49 percent, while taxes are a little bit more. In some areas, for example, the southern counties of Florida, certain parts of New Orleans, Northern California, certain counties in Texas and Louisiana, the percentage increase for insurance may be much higher. The median insurance increase for some of the southern counties in Florida, for example Miami, Palm, and neighboring counties, the cost is around $5,000 a year for insurance. It has increased even about five to 10 percent per year. In talking to reinsurance company executives, they are the 900-pound gorilla in the financial services sector.

Insurance company executives say that borrowers pay more because nobody could provide insurance in some locations if the companies did not raise the prices. Insurance companies want to provide service. They are candid about it. It is something that is still an issue that needs to be dealt with, but the question is how? It is one of the greatest concerns that the OCC has because it is collateral protection. The coverage is the minimum cost to replace the loan amount. Agency staff has heard that institutions are taking on larger bond policies and not requiring borrowers to carry insurance.

That could be a real challenge, because when these types of policies usually have a number of exclusions. It is something to be aware of when buying loans, either through brokers or other banks. He said that force placing insurance is more expensive than the borrowers getting their own policies. Mr. Smith asked the Advisory Committee members about their experience with the cost of insurance and taxes. He also asked about the costs of force placing insurance if borrowers let policies lapse.

An Advisory Committee member said that in some areas the cost of flood insurance has increased, and it is a challenge for small lenders to lend in those markets. He said that his bank has not lent to borrowers that were situated on the water. He said that flood insurance costs are skyrocketing. Also, real estate taxes in New York City markets are increasing anywhere from 30 to 50 percent or higher and the limitations on the city council's rules about rent regulations and good cause evictions. He also the issue of debt that families are currently incurring, and his bank is looking at debt consolidation.

Another Advisory Committee member agreed that insurance costs have gone up in his community. Taxes also have gone up because the price of houses have increased as the city has become popular. But so far, his bank has not seen anything that would indicate an increase in past due loans. He said that his bank has a range of home loans on the books. He said that it is okay, but there is a cloud out there. He noted that there are some issues with borrowers who have insurance, but it is uncertain that they are keeping the policy up as the value of the house goes up and the loan is seven years old.

Mr. Knott said that he had heard that in areas where there is a large volume of forced place insurance that borrowers tell lenders that it is less expensive to have forced place insurance. He noted that it speaks to how much the insurance prices have gone up. He had also heard about borrowers who were not able to get insurance are keeping loans that they can otherwise pay off so that the bank forces places insurance.

Another Advisory Committee member said that his bank had not experienced any issues with availability or affordability of insurance but that they are starting to see that premiums are starting to escalate. It likely will impact new lending and underwriting and possibly affordability of loans and delinquencies going forward. He said that he is indirectly aware of the flood insurance issue highlighted, which is if the bank is located anywhere near a coastal area or has a majority of flood areas in the primary lending area, the availability of both the homeowners and flood insurance can be a real challenge. He sees the storm coming.

Another Advisory Committee member said that his area has infrequent weather events that impact homeowner's insurance prices. He said that a current issue right now is auto insurance in his area. Mr. Smith noted that that is a big problem in Florida as well. The number of uninsured motorists in Florida is in the double digits.

Another Advisory Committee member said that he does not have anything to add to what has been said, but he has a comment about escalating costs. He said that a lot of the costs in the Northeast are the result of mitigation of environmental issues in older homes whenever they are damaged in storms. Costs of repair are astronomically high in New York to mitigate mold, asbestos and other issues. Those are some of the hidden costs that are creating the escalation in prices. It is not just the storms it is how the damage is required to be fixed. The escalation of costs is not sustainable.

An Advisory Committee member noted that it will be interesting to watch what happens in Western North Carolina. Most of the property owners did not have flood insurance as it was not required. About ten percent of the borrowers that had damage had any type of flood insurance. It was such a mud and rock event and not a wind event. It is going to be devastating for not only Western North Carolina and Eastern Tennessee, but also to watch what happens with insurance going forward.

Another Advisory Committee said his bank forced placed insurance with just enough insurance to cover the loan with the bank and that is an eye-opening experience for the homeowner after an event when they do not have insurance other than the amount to cover the loan with the bank.

Another Advisory Committee member said that he hopes that enough of his state was not affected by the insurance events that insurance companies will not leave the state. He said he expects that premiums will increase, but he hopes that premiums will stay at levels that consumers can afford them. He noted that force placed policies do not cover contents. He also said that taxes have increased and that there was a referendum on the ballot that caps taxes in the state based on inflation, based on CPI.

Mr. Smith concluded the discussion but saying that the retail lending market is stable, but there are headwinds and the OCC is paying close attention to those headwinds.

State of Mutual FSAs

Ernie Knott, an OCC Financial Analyst, introduced himself and provided some background information about himself and his work with the Mutual Savings Association Advisory Committee. He noted that he has been presenting to the Advisory Committee for ten years.

He explained that his agenda is in four parts. The presentation begins with portfolio demographics, which are mainly bank structure data, charter changes, charter type and distribution by state. Then the presentation covers supervisory information, which is information mainly from exams, including supervisory ratings, risk assessments and exam cycle. Financial information is the third piece, which is from the call report and will look at capital, asset quality, earnings, liquidity, and sensitivity. The fourth part is on economic challenges.

Mr. Knott started with a description of the broader portfolio comprising OCC-supervised institutions. He explained that mutual FSAs are the third largest in terms of number of charters. Slide three shows that, mutuals represent 10 percent of OCC-supervised bank charters and about $36 billion or 4.3 percent of community bank assets. Those numbers do not include either OCC-supervised mid-size, trust or large banks. There are no mutuals in those categories

Slide four shows that that OCC-supervised banks continue to consolidate. The mutual industry also is consolidating. There are 93 mutual FSAs, but there are also 204 mutuals that are supervised by the Federal Reserve and FDIC. Like the industry at large, mutuals are consolidating.

Slide five shows the trend of FSAs since 2011 when the OTS integrated into the OCC. In July 2011, 649 FSA charters came to OCC. Looking at year end 2023, the number is down about 61 percent, but the number of mutuals has not declined as quickly as the number of stock FSAs. The current net loss rate this year is about 3.3 percent of FSAs. That is a little higher than the industry number of 2.3 percent. He also pointed out that the other important factor is not only mergers, but there have been so few de novo charters coming into the banking system. He said that from 2012 to 2023, in the post-Dodd-Frank era, there were a total of 67 de novo charters in the period compared to 1999, when there were 232 banks in that year alone. He reminded the Advisory Committee members that the most recent mutual that was chartered was Walden Mutual Bank, in New Hampshire.

The slide does not show that 44 mutuals converted to stock charters and 38 stock FSAs converted to national banks. There are also 77 FSA charters that were acquired by national banks. The result is that 60 percent of the outgoing assets, are still with OCC in some form.

Slide six shows what Mr. Knott refers to as the expanded mutual definition, where the stock FSAs that are subsidiaries of a mutual holding company are included in the numbers. When the 27 MHCs are added to the mutual number, the total represents 50 percent of the FSA population. He also noted that about 36 or 15 percent of FSAs have elected to operate as covered savings associations.

Slide seven shows the asset distribution of FSAs of both charters. The chart shows that mutuals are typically smaller in size. Twenty eight percent of mutual FSAs are under $100 million in assets. Less than half of stock FSAs are that small. on the high side, only nine percent of mutuals have over a billion dollars in assets. About 50 percent of mutual FSAs have been operating for 100 years and 90 percent are over 75 years old.

Mr. Knott turned to slide eight which is a map showing the distribution of mutuals by state. This slide includes the MHCs that have not issued stock in the number of mutuals. Mutual FSAs are in 36 states, and they are concentrated in the Midwest and Northeast. Ohio has the most with 16. Pennsylvania is second with 10 followed by Illinois and New York.

Slide nine begins the supervisory information. Mr. Knott described the distribution of composite ratings and noted that the overall condition of mutual FSAs remains satisfactory. 97 percent have a composite rating of one or two. The bottom of the slide shows the specialty ratings, i.e. information technology, asset management or trust, consumer and CRA ratings are also satisfactorily rated.

Slide 10 shows leading indicators or more forward-looking information because before there is a downgrade in the composite rating, there is usually at least one or more downgrades in the component ratings. In the chart at the top of the slide, there are more downgrades than upgrades and it shows where the most downgrades were. Liquidity was downgraded frequently during this time period. He noted that in this environment, the pressure on net interest margin earnings was the second most frequently downgraded component.

Mr. Knott also pointed out that said before a bank's composite rating is downgraded, an MRA is issued. He said that looking at the volume of MRAs shown in the chart on the slide, by exam area, the volume is up 54 percent. He noted that most of the MRAs were for enterprise governance and when he drilled down, he found that MRAs in audit, strategic and capital planning and vendor management were the most common. However, he found that BSA and AML increased the most for mutuals over the last year in terms of numbers of MRAs.

Slide 11 shows the risk ratings and shows that the top three increasing risks for mutuals are liquidity, strategic risk and interest rate risk. Mr. Knott said that for other types of banks, credit usually is in the top three, but not with mutuals and he said that that speaks to how strong asset quality is at mutuals. He also said that in the latest OCC Semiannual Risk Perspectives liquidity was under pressure in general. It was not just reflected in higher rates, but competition for deposits. The bottom chart on the slide shows how many FSAs have an 18-month supervisory cycle. All mutuals are eligible except for two based on size.

Slide 12 is the first slide showing financial information. Mr. Knott said that when he is asked to make a presentation to boards of directors, he prepares a custom presentation and added a line for the bank ratios so the board can have that perspective as well. He is that looking at the capital levels that capital remains strong and stable. He noted that the difference in the rations between FDIC and OCC-supervised mutuals has increased.

He said that starting in 2015, banks had a one-time election to opt out of AOCI or in other words, not included in the leverage ratio. He said that means that the bank is not seeing the impact of unrealized losses in the leverage ratio, but it is seen in the equity capital ratio. He said that he thinks that the equity capital is probably a better measure right now because capital is a financial cushion against unexpected losses. But if the bank has a heavily depreciated investment portfolio, it is not such a cushion.

He pointed out the relationship between the leverage and equity capital for mutual FSAs is 58 basis points. But for the FDIC peers, it is 94 basis points. Not only are mutuals FSAs more highly capitalized, they have less depreciation. In looking at the equity capital ratio, they look even better. Because different sizes of mutual FSAs are represented in the room, the chart on the bottom right breaks the ratios out by regulator and asset size. The chart shows that smaller the banks usually have the higher ratios.

Mr. Knott turned to slide 13 and pointed out that 99 percent of mutual FSAs are well capitalized and rated either one or two. He noted that there are two ways to determine if a bank is well-capitalized. If the bank opted in to the community leverage ratio framework, it needs to maintain a nine percent ratio. The bank does not need to complete the total capital information.

Slide 14 shows that asset quality is resilient. Mr. Knott explained that he means that in looking at the total past due and OREO amounts, they are low and stable at 0.86 percent. He broke out the actual number of the 30- to 89-past due numbers or the early-stage delinquencies and the non-current amounts. It shows that the 30- to 89-days past due amount is a decade-low at 0.42 percent. Looking at the allowance for credit losses, it is a little higher. They are adequate and higher compared to pre-pandemic levels. He said that there is still a chance of recession, but for that reason, it makes sense that the allowance right now is a little elevated compared to 2019. Looking at the asset quality ratings on the very bottom left, this is the only group that does not have a three in the legend.

He turned to slide 15 that shows that loan growth has declined, but it remains moderate. He pointed out that on the chart on the bottom on the right, looking at the loan mix, mutual FSAs are different based on their loan mix. Sixty-six percent of the loans are residential loans, and he said that that is one reason for the strong credit quality, because the loans are well underwritten. The second category is commercial real estate, which is a combination of non-farm, non-residential at 15 percent and multifamily loans and construction and development loans at 25 percent.

Slide 16 shows that the median for losses for most groups is zero. Currently most banks do not have losses. So, the median is zero. He said that he looked at the weighted average of the 93 mutual FSAs and it is very low at 0.02 percent. He said that it is interesting that all the losses are from consumer loans.

Slide 17 shows that earnings ratings have weakened. They continue to lag the ratings in other safety and soundness areas, and it has been that way for quite some time. Seventy-five percent of mutual FSAs are rated 1 or 2 and the biggest changes has been in the 2-rated category. The chart on the upper right shows the median ROA of mutual FSAs, there is a decline for the second consecutive year and a third year of decline for the FDIC mutuals. The chart on the bottom shows the distribution of ROA by size. Mutual FSA earnings are usually on the lower side and the higher ROAs are at the larger institutions.

Mr. Knott turned to slide 18. Because the median is drawn from the bank in the middle, the margin compression is more evident. The income statement on the upper right of the slide shows that the interest expense went up 100 percent over the last year. That was the driving factor that caused the contraction in net interest income. In the chart on the bottom of the slide, the numbers on the very far right are broken out. Because non-interest expense is the largest category on the bottom left, that is broken out. Non-interest expense declined 2.67 percent year over year. He said that he thought the number was impressive for this group.

He said that year over year, net interest margin contracts. Slide 19 shows that in the second quarter of 2022, when the Fed raised rates 25 basis points at that March meeting. Assets repriced immediately upwards. Banks were in no rush to cut their rates because there was so much liquidity and pandemic-related deposits. The environment tightened in 2023 and finally, in first quarter of 2024, second quarter, the OCC FSAs increased one basis point quarter over quarter and the FDIC population did stabilize as well. About 60 percent of mutuals had an increase in their margin this quarter versus last.

Mr. Knott said that the line on the bottom chart shows net interest margin. The columns are the numerator, the net interest income and the line is the denominator, average earning assets. Normally, when there is see compression, the numerator goes up at a slower rate than the denominator. It did into this time. There was a decline in the numerator. That is why he highlighted those columns in red. There was a decrease of 81 million or about nine percent the numerator and net interest income.

Average earning assets grew about four percent, resulting in the compression of 35 basis points. He said that he would break out that 35 as well, because what was interesting for that 35, the assets repriced upwards at a slower rate than the liabilities during this period. Assets during second quarter 2023 to second quarter 2024, which is the current quarter, assets increased 51 basis points, but the cost of funding those assets increased 86 basis points, resulting in the compression of 35 basis points. And the concern here, especially for smaller institutions is that compression is felt most by the smaller banks. He said that there were more mergers during those periods. Banks with NIM pressures exit the banking system more quickly, especially if they do not have sufficient scale or do not have a specific niche in the community.

Mr. Knott turned to slide 20. The efficiency ratio is a concern for smaller institutions because of lack of scale and because of earnings. It is not surprising that there was an increase in the efficiency ratio. About 28 percent of mutual FSAs had an efficiency ratio over 100 percent which mean that it costs more than a dollar to create that next dollar of revenue. The breakout is in the chart at the bottom of the slide and scale is important.

Slide 21 provides information about liquidity showing that there are a number of downgrades from 1-to 2-rated in the component. Mr. Knott started with the ratings on the bottom left of the slide that shows a shift. A year ago, 62 percent of mutuals had a one rating and that is down to 42 percent. The shift to a two-rating started in the second quarter of 2022. He turned to the chart showing deposits and said that quarter over quarter, mutuals as a group had a 38 percent increase in deposits. He also noted that, there is a higher percentage of non-interest deposits, which is actually higher than pre-pandemic. The percentage of brokered deposits has come down a little bit, about 1.04 percent. Community banks as a whole have increased brokered deposits about seven to eight percent

Slide 22 shows that mutual FSAs reached a cyclical peak in 2021, and then on-hand liquidity ratio fell for three consecutive quarters. Because of the declining on-hand liquidity, mutual FSAs are relying more on wholesale funding. 5.04 percent of mutual FSAs report up .4 percent. Both of these charts show that mutuals have a higher on-hand liquidity and lower reliance on wholesale funding than peers. Mr. Knott said that the Federal Reserve's shift in monetary policy should provide some relief on these numbers going forward.

He explained that slide 23 is new slide in this presentation. He noted that there is a 100 percent increase in the cost of funds. Looking clockwise on the slide, the upper left is the cost of deposits. It has increased since 2022. The chart showing the balance sheet shows total deposits in the second quarter of 2024. It is down at 91 percent compared to pre-pandemic in 2019, which was 95 percent. He said there are fewer deposits and there are more other borrowings currently. The chart on the bottom right makes it easier to see. The non-maturity deposits which are low cost, and do not reprice as often. They are shown in orange and gray, demand deposits and money market and other savings. He noted that in 2022, 25 percent was in demand deposits. It is now 23 percent.

Looking at money market and others, 49 percent in 2021 and 2022 and currently it is 39 percent. Looking at the time deposits under the insurance limit, the amount is eight percent higher. He said that in other words, as rates went up, the depositors with money in money market accounts and other savings, looked for higher rates. They came to mutuals, and they negotiated CD rates and that was the flow that came in. The last chart on the slide shows the breakout based on the each of the areas that line up on the UBPR. The chart shows the movement and as the Advisory Committee members have noted, customers will not move for 25 basis points, but they will for 50 basis points. A lot of bankers have said that they get on the phone and see what they can do to keep deposits.

Looking at the top of slide 24, mutual FSAs continue to be well-rated in sensitivity. The bottom chart shows investment depreciation. He said that it includes depreciation, not only from the AOCI, which was available for sale, but also includes held for maturity. The slide shows total depreciation, which is one of the canary ratios the OCC talks about. During the period of Federal Reserve tightening, Federal Reserve rising rates and quantitative tightening, mutuals FSAs have minus 8.6 percent. There are community banks that have a lot more, well over 50 or 100 percent during this period.

Mr. Knott explained that slide 25 is a quick summary of the points in the presentation. Slide 26 shows an economic projection. He said he would not go over the projections but would make some comments. Slide 26 shows the “dot plot,” it is the summary of economic projections, and it comes out quarterly with the Federal Reserve’s press release. The 19 members of the Federal Open Market Committee give their projections on where they think GDP, unemployment, inflation, and the Fed Funds rate will be at the end of each year. he described the slide showing the dot plot. It can change at each meeting. He said that there is a solid economy how. He provided some comments on his view of the economy and what may change.

Member Roundtable with the Acting Comptroller

Ms. Bahin introduced the Acting Comptroller, Michael Hsu, for the member roundtable discussion. Mr. Hsu said that he heard that the morning discussion had been robust and said that he wanted to hear from the Advisory Committee members.

An Advisory Committee member thanked the Acting Comptroller and described the questions that had been discussed about the FHFA’s new credit score model that were raised in the Mortgage Roundtable discussion. The Advisory Committee member described how the new credit systems are going to affect consumers. He asked how much discussion and cooperation the OCC and the other primary banking agencies had had with the FHFA because the implementation dates are rapidly approaching. He said that the banks can adjust their systems, but he is concerned for the consumers. He said that the changes will result in consumers being turned down for mortgages on a strict credit scoring basis. He said that he is a portfolio lender, and his bank does not use credit scores, but they use a blended view of debt coverage for applicants.

He said that if the proposed changes are implemented, even for portfolio loans that are pledged to the Federal Home Loan Bank for borrowings, it will have to have component that the bank is following regulations. He asked how the OCC is coordinating with FHFA.

The Acting Comptroller said that the primary federal banking agencies engage as much as they need to and then some. It really depends on what level and what the topic is. He said that this topic is a great example of where the agency's direct engagement with the Advisory Committee members can lead to the kind of interagency engagement the banks are hoping for. He said that he wants to make sure that the OCC staff is engaging appropriately with whoever the agency is. OCC staff have been engaging with FHFA on a range of issues typically related to funding.

The Acting Comptroller said that working with the FHFA, especially in funding, has been top of mind for a lot of banking institutions since last year's turmoil and in light of FHFA's 100-year review of the Federal Home Loan Bank System. The OCC engages with the agency and with stakeholders to make sure that are the industry participants, and the agencies are we on the same page and what the direction of travel is. He said that he did not know the details of the credit score changes but now that it has been raised, engagement will increase.

An Advisory Committee member asked a question about the OCC's redlining and fair lending reviews. He said that with the yellow light, red light scenario of looking at applications taken within the MSA as compared to other HMDA reporting banks, he has concerns he said that his view is that redlining is intentionally not making a loan in a certain census tract, the majority-minority census tract. But if data on applications taken is reviewed, looking at banks that portfolio all their loans have different underwriting criteria. They do not have down payment assistance because the bank does not have an automated underwriting system and applications in the minority-majority census tract were not flowing to the bank. Realtors do not send applications to the bank because they know it has tighter underwriting standards. As a result, the numbers of the bank's applications get depressed. That is a measure that is used, but he noted that it may not be the most accurate measure, particularly for a mutual bank. He said that they can take a bunch of applications just to turn them down, but that does not feel good to anybody. He also said that there is a risk to the reputation of the bank if it takes applications just to boost numbers but denies them. He said that he thinks there is a happy medium because if the bank gets a yellow light, it is one thing, but a red light means that DOJ comes into play. He said that he is concerned that if it is just application-driven in MSAs compared to other HMDA-reporting banks, there are some unintended consequences to banks that are really trying to do the right thing.

The Acting Comptroller asked Donna Murphy, Deputy Comptroller for Compliance Policy, to start the discussion. She said that the OCC provides a pretty solid overview of how it looks at a whole range of factors when it is looking at potential redlining. Agency staff does statistical analysis of both applications and originations to identify banks that may have some risk in that area. And then staff looks at a whole range of factors, and those are set out in the Fair Lending Handbook, which is on the website, and pretty substantial. She said that she agrees that looking at just one statistic or one factor and making a determination based on that would be inappropriate. At the high level, that is the answer. She also suggested that the Advisory Committee member look at the Fair Lending Handbook.

An Advisory Committee member said that on behalf of the banks in the south, they appreciated that the OCC allowed plenty of time to reopen after the recent major storms. He said that the OCC worked with the affected banks. The Acting Comptroller said that he appreciated hearing that and that the agency does try to provide flexibility because keeping that bank open is really a lifeline to folks who have lost a lot, if not everything that they had.

The Acting Comptroller said that he had one request or question, to the extent that these disasters may be happening with a little bit more frequency than in the past, there may be opportunities to use banks more to get people back on their feet. In some cases, the government response includes a FEMA component, and anecdotally he had heard that FEMA is trying to get payments out to people and looks for opportunities to partner with banks to try to simplify that process. He said that with his FDIC hat on, he thought about the underbanked, unbanked report, and it note that noted that in some of these emergencies, partnering with FEMA to get to consumers into the banking system and may be bankable moments.

There are consumers who do not have bank accounts, and they are looking for assistance, and actually opening a bank account for them to get that assistance is a way to get them into the banking system. He said that if in the Advisory Committee members' experience, there are opportunities, there is a lot of interest at the federal government level to coordinate a bit more as to it can be done with more effectiveness, with better coverage, and the bankers experiences and ideas would be really valued on that.

An Advisory Committee member said that he knows the FEMA representative is in his town, and he will go by and maybe talk to FEMA, or maybe FEMA could have that guidance directed to the different banks within the disaster area.

The Acting Comptroller asked the Advisory Committee member to talk about his experience working with the agencies in the aftermath of the hurricane. He said he is interested in what happened and what steps were taken. The Advisory Committee member described the lead up to the storm and said that his community had not experienced a hurricane of this force probably in over 100 years. They kept in contact with their Assistant Deputy Comptroller about what was forecast. They contacted their vendors, because the bank knew it was going to be a problem. After a few days of not being able to open or process transactions, they were able to run transactions through a drive-through window, and by the end of a week, the buildings were open.

He said that they knew it was a security risk, so they had to be careful, because there was no way that police could get to the bank if they had a problem with a security event, so they had to be very careful in opening the lobbies. They have building that has a generator, and one that does not, but power came on. All four branches were up by the end of the first week post storm, the preparation actually worked. We learned a lot through the hurricane, which was documented in case another event occurs. He is glad that that the bank staff took the time to have a good disaster recovery program because it was worth it, it may take a year for the city to recover.

Another Advisory Committee member asked about another topic. He asked about the increased use of AI, and the progress that FinTechs are having. He said that it is probably the fastest moving industry he has seen and as a small mutual bank, and he is seeing this trend evolving so fast that it is hard to keep up with. He said that he has always liked gadgets. He had the first Palm Pilot, and beepers, and early cell phones. He said that he is concerned about regulations, and the procedures that need to be in place to protect customer data, how systems are being monitored, all of those pieces are critically important, but it is moving so quickly, that banks need regulatory guidance to be ready to progress. Some of the mega banks are moving into the FinTech space faster than the community banks, and he said that he thinks technology is going to help community banks get their message out, especially mutuals, but they need a roadmap to help get started.

The Acting Comptroller asked whether he could turn the question back for a moment. He asked how the Advisory Committee member envisions using AI? What are the range of use cases that there if there were a wish list the bank could be involved in. The Advisory Committee member said that ten years from now, it might be a Grok, creation of AI, sitting in his chair. He said he is worried about that. He said that his bank had a consultant talk to the bank about a new product that is working on a large language model to help veterans deal with PTSD.

It is called Tranquilla, and the Advisory Committee member spoke to the veteran, and he brought him an example. Some of the bank's tech staff sat in on the presentation. He said that if a person is going through a different stress or financial need they turn it back to the bankers and say what can I do to try to find solutions? And he was able to pivot on the spot to start to offer product opportunities that would help a family get through an immediate financial crisis. The Acting Comptroller asked whether it is a kind of chatbot, the Advisory Committee said it is an AI agent.

It is past chatbots. He said the bank's core system tries to understand how it can help business-to-business communications on certain financial stress levels that arise, because the solutions are out there. If a ChatGPT is used or any kind of large language model, the answers are not accurate all the time, but it is only going to get better. The Model T Ford was a disaster, but a lot of them were sold. That is what is starting to be the trend. The Advisory Committee member said that he does not want to be the person who is shoeing horses when the automobiles are flying by. He said he thinks that the first stage that is going to be important for generative AI to help banks is going to be cybersecurity. His board had a discussion about how the bank can look at opportunities in the future after they get regulatory approval. It is the one piece where the bad guys are going to have a lot more opportunity. They only have to be right once. Banks have to be right every single time.

He said that banks are going to see those attacks come up more quickly and more frequently. He thinks that is the first thing that generative AI is going to help institutions - cybersecurity. The second place is going to be compliance, legal, anything that has any type of need to understand Federal Registers and the data that is inside them. Those are static or dynamic pieces of information that can be uploaded and then interpreted. Now, again, hallucinations are still a very prominent problem, but the importance of having that technology is going to be crucial for community banks.

The Acting Comptroller responded and said that the good news is the agency and the industry do not have to start from scratch. The OCC has existing guidance with regard to model risk management and new products and services that provide a good framework as a starting point to how should banks and the agency approach AI, generative AI, pick the new thing. That guidance is principle-based so banks can start somewhere and have some guardrails. For example, what will the bank use it for? What are the guardrails? What are the areas that have to be consulted with prior to moving to the next stage? A lot of that is common sense, but there is guidance that can lay out some issues to address, at least as a first cut.

He said that there are nuances to what a bank can do. It is more complicated when third parties are involved, especially if there is an activity that is customer facing. The stakes are higher. He said that the one thing that the OCC is seeing with some of the larger institutions is they have set up good internal controls as employees experiment, for lack of a better word, or pilot different use cases. Because that is what everyone is trying to do now as they look for the next killer app. What is the use case that is going to be the most useful? Trying different things in a well-controlled environment and drawing some very clear lines around what is appropriate or okay and what is not so there is clarity on how the activity can evolve in a banking setting.

He said that is what the OCC is doing internally. The agency is going to practice what it preaches here. The agency is being open-minded about recognizing that this technology potentially will transform many if not all aspects of the business, so staff want to be in there using it, but it has to be safely.

He said that anytime an OCC employee clicks on particular items, there are three pop-ups that show up, asking whether they are sure and letting them know the rules and the permitted uses. Within those parameters, they learn how to use it. Of course, it is important to talk to the bank's examination team because the agency is learning these things too. Staff is getting a collective sense of these use cases, what kinds of controls are prudent, and what the agency needs to ask more questions about.

He said that the information should be communicated back to the banks. The agency recognizes that larger institutions are going to have an inherent advantage in terms of resources and scale that community banks will not have. That could, if the agency is not mindful, create a bigger distinction between the haves and the have-nots, which would not be fair.

At the same time, the Acting Comptroller acknowledged, there is a lot of hype, and he has noticed that what gets publicly reported and what gets talked about at investor conferences is a bit ahead of what is actually happening on the ground in the financial services area. He said that he thinks that is a data point and not to believe everything that is the press about launching the next, grok model for underwriting. He said that it is important to keep a human in the loop. He said that it is good that the industry is looking at developments prudently and that the regulators and industry will engage on this quite a bit, especially in more group settings to make sure that collectively everyone is on the same page.

He said that while there is excitement around the developments it is important to recognize that there are some dangers and risks. He agrees with the Advisory Committee member who raised a point about cyber risk and said that it is what keeps him up at night more than imprudent use by the bad guys. He said that especially for scams, fraud and cyberattacks, the tools make it easy for bad actors to do bad things. He said that the industry and the regulators have to be mindful of the bad actors and work together.

He said that in the cyber area, there a good framework for sharing information, notification rules. In the fraud space, there is work to be done. Fraud is up. The AI tools will make it even easier for the fraudsters and the scammers. He said that everyone will have to work extra hard to keep that manageable.

An Advisory Committee member said that it is good to hear that as a primary regulator, the OCC is already looking at some of those options and utilizing a team in a sandbox or in a controlled environment to see what would be helpful and what is really outside. He said that it is important for the agency to get the data and share it with exam teams, and has conversations with them, maybe even having special sessions with the IT folks would be critical at that level.

Ms. Murphy said that the Advisory Committee members can reach out to the Office of Financial Technology, if there are questions. In the meantime, there are two recommended publications when they are looking at potential fintech partners. There is a 2021 interagency guide that is generally applicable but was specifically written with community banks in mind for due diligence of potential fintech third parties, because there are specific questions that should be asked. Fintechs do not necessarily look like traditional third parties. For example, they do not necessarily have 10 years of audited financial statements. She said that the guide goes through those requirements specifically.

More recently, as an interagency group, the agencies updated the third-party risk management guidance, which is very comprehensive. She said that not quite a year ago now, the agency issued a guide for community banks that goes through some specific examples that agency staff has seen community banks encounter, where there are some questions about how to apply the third-party risk management guidance. Both of those are good resources.

An Advisory Committee member said that his bank is partnering with a local college that has a venture and innovation center. The bank also teaches financial literacy at the college. A professor told the Advisory Committee member that a student is designing a fintech app, a financial literacy app. It is called Financially Lit. The student asked to do a presentation to the bank, and they had her meet with the management team. The Advisory Committee member said that he realized that once something is mobilized and it provides a better financial understanding, they will use it continuously. In this particular case, the student, gamified it so that as the user answers questions, they get points. Then they can go to the bookstore and buy a university shirt or a hat or whatever is needed or food. He said that is what young people are interested in. They are all sitting at home on their Ataris or games.

It gives them an incentive to do something that is going to make their financial health be more in focus. He said that is the whole future. When I speak to that fintech and start to explain to him that the industry has a lot of regulations. Fortunately, the code writer, who is a veteran, is also from the banking industry. So, he knew how highly regulated institutions are. That is critical.

The Acting Comptroller appreciated the anecdotes because it helps make the developments a little bit more concrete. That gamification point cuts both ways. There is the version that is being shared which is a great story because it is using that as a vehicle to educate, to get people to be more literate and to empower them and that is fantastic, especially younger folks who are losing their phones, as anyone with kids knows. At the same time, that gamification can have the opposite effect. It is possible for people to, and there have been cases where it basically overrides more rational functions and gets them to do things they otherwise would not do.

He said that this is a warning again. These things can be used for good. They can be used for ill. The agency wants to make sure that as bankers are all very knowledgeable and experienced in things that can build trust and that can erode trust. That is not always the case. People who work in the non-banks have a different relationship to these things. He said that it is good that the bank is mixing the people who are at the table. Because if it is a table just of bankers, there will be just one response. If it is just technologists or students, there will be a different set of responses. It is that mix and get a regulator at the table, because then they can provide that perspective. The Acting Comptroller and the Advisory Committee member agreed that it is a great idea.

An Advisory Committee member said that there had been a robust discussion this morning about affordable housing and the broad spectrum of affordable housing. Bad news is that the group did not come up with any solutions. He asked the Acting Comptroller what he is seeing because bankers can play a role. The Advisory Committee member said that government at all levels – local and federal – plays a role with down payment assistance and funding and regulators will play a role. He asked what the crystal ball looks like?

The Acting Comptroller said that he does not have a crystal ball, but he said that this issue comes up in different settings. The agency has a lot of interactions with community organizations, and they bring it up a lot. He said that in almost every community that he has been to when he makes a visit he meets with bankers, OCC staff, and community organizations to get those perspectives.

Affordable housing comes up every single time. Also, the agency has Project REACh, which is a vehicle where the OCC is trying to reduce barriers to financial inclusion. Affordable housing is just one of those. In looking at wealth creation in the United States, housing is a huge component. The affordability crisis is very real. He said that the Advisory Committee members know the data better than almost anybody. It is a multi-pronged problem, a supply problem, an interest rate problem, a zoning problem and a down payment and affordability issues problem. They all compound.

He said that there is no one magic bullet. There are some interesting efforts out there. Within Project REACh, he said he can describe a couple of these attempts where there have been some interesting down payment assistance efforts. The details on these things matter. He said that he would let the experts share the use of community land trust. That is one example of something that has been discussed in Project REACh. There was a meeting last week about it in terms of enabling affordability on a perpetual basis for certain properties. There is another group OCC staff met with in New Orleans teaming up with health insurers.

Because if health insurers can get certain services on the premises for the residents, their health outcomes and financial outcomes are better to the point where some of the properties can be underwritten with the health insurers in the capital stack. There are pilot projects that try to address this. OCC staff can share some of the initiatives with Advisory Committee members and see if it the programs are applicable in for them. He said that he thinks that the agency and the industry will learn from them collectively and share the ideas. Because not all of these are going to work but some of them might.

The Advisory Committee member noted that the OCC can look at nationwide programs, but he is limited to a much smaller area. He is interested in hearing about what is working elsewhere as it may be able to be replicated in his community. He also said that as far as the financial piece of the solution, he believes that mutuals best suited to play a meaningful role in that because of the charter, history, ownership structure, capital base, and asset quality. The Acting Comptroller asked the Advisory Committee members to share their success stories.

An Advisory Committee member said that his bank is working on a co-op in Winston-Salem. That is an interesting model where residents can co-op and then build some equity while renting almost a rent-to-own type of facility.

Ms. Murphy said that another of her policy areas is CRA. She said that she is not able to talk about the rule that is currently in litigation. But one of the things that the OCC has developed and that under the current rule, is available to any OCC-supervised institution is what is called the CRA Qualifying Activities Confirmation System. Because one of the requests the agency gets all the time when there is something new or novel, staff is not sure whether it will meet the requirements for CRA credit, and the next examination may be four years away. To address that, a couple of years ago, the OCC set up a website where any OCC-supervised institution can go in, put in the details of the project that they are thinking about doing, and ask, will this qualify for CRA consideration? And a definitive answer from the OCC that is between the policy folks and the exam folks is provided.

Staff collaborates on the responses and banks can have some assurance going into the next CRA exam that it going to get consideration. It is a very simple thing, but it is a favorite supervision technology tool that has been developed in the last couple of years, because it really does address a need that is out there.

An Advisory Committee member asked a question about liquidity and some of the things that his bank is being told about how liquidity is being perceived in the marketplace. And the liquidity models that his bank uses switch from cash, on-balance sheet, on-balance sheet plus borrowing, to then also include a timeline, day one liquidity, week one, and month one, and all of that has been integrated.

One of the questions that he is hearing in the marketplace that does not affect mutuals as much, but he is hearing it from other mutuals. As deposits become more difficult to attract, there is more competition, there is continuing, especially in the bank’s region and maybe everywhere, pressure from credit unions that seem to be able to pay a little more for a lot longer than banks want to. He said that his bank is being told that it is not just the quantity, but also the quality of the liquidity.

He said he has two basic things that he wants to ask about. He said that he knows the OCC does not like to give opinions about some of the things he has heard but he is seeking information. He has heard that brokered deposits or listing services are going to be treated differently from how they were treated historically.

The second question is why if the balance sheet is a snapshot in time, there is scenario with the FHFA coming out about the 100-year report. There has been a lot of criticism and pressure on the Federal Home Loan Bank System, which basically provides all of the bank's liquidity on the borrowing side, whether it be off of pledged securities or pledged loans.

He said that he has been told to find alternative means through the Federal Reserve to do that. He said his bank has done that for a lot of cases. But the bank still does not get credit on balance sheet for pledged securities, even if they are not encumbered. His bank is ending up unpledging the securities so that it can have them because the bank never borrows. It takes away liquidity and hurts the liquidity in the system just to try to meet some of the criteria. He said that he thinks it might have a negative repercussion.

He asked how the OCC is viewing the alternative funding sources that are available to banks as he continues along this line? And in the bank's market credit unions are buying banks and the industry has enough competition. Now banks have got to compete with another non-tax entity that used to be taxed.

The Acting Comptroller said that he would start at a high level and look to other OCC staff to add details. The three agencies after the spring turmoil issued an interagency statement on contingent liquidity and liquidity risk management generally. But the focus really was on liquidity under stress. That is ultimately where the agency's focus is. Are banks prepared under stress to be able to deal with changes in liquidity? In broad brush strokes, it is not earthshattering, but the idea is to make sure the bank has planned appropriately and that there are no surprises. Some of those surprises would come from undue concentrations, et cetera. Those principles are not anything anyone would argue with.

He said that he thinks what has happened is that the deposit landscape in general has been changing for some time. What a high risk is versus a low-risk deposit has been evolving and will continue to evolve. Where do broker deposits fit in and how are they classified? Where do uninsured deposits fit in? How are they classified? These are all live questions.

He said that with his FDIC hat on, he reminded the Advisory Committee members that broker deposit rule was proposed asking where these things are being classified. Then there was an RFI on uninsured deposits. There are a lot of questions about getting it right, because if the FDIC gets it wrong in terms of how it is thinking about the riskiness, the industry and market are in trouble.

And then on the FHFA, FHLB study is a project that has been underway for some time now. It is a 100-year review. He said that he thinks the FHFA has clearly signaled where it wants things to go. They want a return to the mission, the core mission of the FHFA and the FHLB System and in some cases that may result in a change.

He said that as bank supervisors, they just want to make sure that the agencies are not behind the eight ball on that change. If that change means the following things, then banks have to adjust to that. He said that one of the more notable bulletins put out by FHFA was saying this lending is not merely collateralized asset-based lending, there is a counterparty credit component to this, which is part of their calculus. He said that in 2008, there was a huge surprise when the broker dealers, which were doing all repo funding, were getting cut off by the street because the street said, it has the Treasuries, but it does not like the broker's name. And that surprise was fatal for some firms. He said that the nice thing here is that there is having an open conversation about this. FHFA has clearly signaled, here is how the agency is thinking about it. The agencies as supervisors and banks got it. Message received.

Banks can make sure the contingency funding plans, aligns with that viewpoint. If it does not, then adjustments have to be made. The agency is willing to engage with banks and make sure from a supervisory standpoint that the agency has some comfort around how banks are thinking about that and how it lines up. He said that is the big picture. There are details there which are super important.

Mr. Thornton said that he has been visiting a lot with the local Federal Home Loan Banks in his Regions. And it has been an interesting process. There are not any significant known changes yet, but they are hitting all the issues - the return to the mission, that was obviously part of the message to them. They do not see it is going to be a big change for Dallas or Atlanta, but they are taking a wait-and-see approach on how significant it could be for them.

The Advisory Committee member said that he has heard a lot of good things have come out of that. He thinks there is agreement that the direction is the right direction. It is what the Acting Comptroller was talking about in the details of the implementation that makes it a little bit difficult from the standpoint of the way that the industry is are set up currently. The Advisory Committee member said that it is something banks were used to, that the system was what banks were used to. Now operationally moving some of those secured assets to the Federal Reserve, moving them back, it is a lot more cumbersome than it looks and it is a lot more time consuming and a lot of other little issues pop up.

In general, he said he does not mind that maybe the FHLBs need to do a better job on their credit underwriting for certain institutions. He can see that because he knows what his bank's is and he can see what others, and he can see what they are lending out there because his bank is a member. His bank pays attention to what these annual reports are saying.

He said that he is in total agreement with the FHFA on some of this stuff, but on some of the other aspects, they do provide that comfort for the bank even though the bank has not used it historically. He said that he is switching collateral now in between, and that is operationally is a bit of a headache and maybe that is a small price to pay, but maybe in this, the systems at the Federal Reserve get improved so that it can be a more fluid aspect.

The Advisory Committee member said that he had forgotten to mention about whether the broker and listing services is the uninsured deposits, even a bigger issue with the ICF, the CDARS, those two programs now they are talking about, now they are insured, now they are not insured. How are they being funneled around? He knows it is a fair point, and he understands both the good and the bad, but at the same time, if the banks cannot have these programs and they compete with the other entities that do, it puts the banks at a disadvantage. He said that it is not as big of a deal for his bank, but he is talking about institutions in general in the metropolitan New York market.

Ms. Cole said that she thinks one of the things that banks may hear some of the examiners ask about is if FHLB lines hold what is the backup, and in times of stress, what the agency knows is banks will say they just go to the Fed discount window. As the Advisory Committee member noted, going to the Federal Reserve discount window is much more complex than picking up the phone and saying, the bank would like a line today. It means that the bank has got to present its collateral, which in many cases is its loans, and the Federal Reserve has to go through its process, and it takes a while to do that.

She said that the agency has had some banks that have had the FHLB lines realize that they have pledged their entire assets, and getting those released in a time of crisis when the bank absolutely needs the other option takes a lot more time. Some institutions may not have that time. So that is a concern to the OCC because nobody wants to see a bank not exist simply because it could not get a line of credit at the Federal Reserve that it needed because the bank could not get its collateral released.

She also noted that in some cases, the agency has had institutions that have been on the border of different Federal Reserve districts, and the banks do not even really realize which Federal Reserve Bank is theirs. It is important to test the lines well in advance so that the process works when needed.

An Advisory Committee member said that because the OCC have been beating that drum, and that is one of the positive things that came out, certainly from his experience, is that his bank has never borrowed. The bank has had a pledge just at the FHLB. Now the bank has tested the line, and that is solely because of the OCC's direction. That has been a really good thing. The bad thing is the mechanics of doing all of that is costly and painful. That is a necessary evil at times, but it does not need to be because the technology is there for it to be a lot easier. He is not talking about approving loans that is pledged for collateral. He understands that. He credit-underwrites all day and that takes time. He is talking about the stuff that should be easy, but it is really hard, and it should not be at this point in his opinion.

Ms. Cole said that she thinks everybody is trying to get better at it and make it easier. The events of the spring of 2023 are what heighted this issue because just after the failure, the speed at which the agency saw customers moving their accounts to different institutions, and even from institutions that were healthy, that the agency had no concerns about. But all of a sudden, things were showing up on social media or they were showing up in the newspaper, but somebody was on the list somewhere and they were being adversely impacted. In some instances, there was no rhyme or reason to some of the noise that was out there, but perception becomes reality. In some cases, when social media or other news articles focused on particular things that the agency knew about and thought, it is not an issue, all of a sudden it became an issue or could become an issue. OCC staff thought how does it mitigate this risk to the institution?

Mr. Thornton said that was actually glad to hear the Advisory Committee member mention the testing piece because even though collateral has been pledged and the lines have been established, the next question is, does the bank really have to test it periodically? They do. Otherwise, operationally, the bank's staff will not know how to exercise it. The Advisory Committee member said it is like launching a missile someday. The operator has to turn both keys and get the right sequences.

Ms. Klien said that she has been on calls with several Federal Home Loan Banks in the West and Midwest. The regions cover a big geography and banks in the Regions belong to the Federal Home Loan Banks of San Francisco and Des Moines. The Federal Home Loan Banks have talked about some of the differences among the FHLBs. She thought they would be all homogenous, but they are not. They are independent banks. They talk to the OCC about how they work with the Federal Reserve. Some of the FHLB's work with multiple Federal

Reserve Banks. Some of them only really work with one Federal Reserve Bank. She thinks that the more Federal Reserve Banks that they work with, the easier it is think about collateral.

She said the FHLBs talk to the OCC about testing, and their minimum testing line is $1,000 so it should not cost banks a lot to be testing those lines. She heard the Federal Home Loan Banks talk about the Federal Reserve, and how they together and share information. Ms. Cole said that an Advisory Committee member brought up the importance of the bank's internal staff knowing the process. She suggested having a cheat sheet of step one, step two, step three, because sometimes in a crisis, the other thing that OCC found is the staff that do it every day or know how to do it are on vacation. They may be on a mountaintop and cannot be reached. The bank staff that is there is scrambling, which makes it doubly hard. An Advisory Committee member said that when the crisis occurred last year, banks see how catastrophic it could be as quickly as that happened. It raised everybody's eyebrows and raised awareness that banks should make sure that all the processes are in place.

The Acting Comptroller said speed is the X factor here. In the past, banks had time and could work through a weekend or two to get everything done. He said now it all has to be done the day of or the hour of the event. It is like the disaster recovery planning the Advisory Committee member was talking about earlier. Banks do the prep in peacetime, iron all those issues out, become familiar with them and then in wartime, the bank is prepared.

An Advisory Committee member said there is a basis for some of what happened in California. It can be identified, and banks may think that it will not happen to them because of this and this. Social media today really has a flashpoint for everyone.

An Advisory Committee member said that in East Tennessee FEMA had to back off for two days because of rumors that were totally bogus, but that stuff can build, and it can build about a bank just as easily about a government agency. An Advisory Committee gave an example that occurred before his time at the bank. There was a reverse run on the bank. Just as the internet started to get popular back in the 1990s, there was a rumor that the bank was going public and there were loads of people pulling up to the main office. Management at the time scrambled to try to figure out how they can slow the deposits coming in. They went through zip codes, geocoding, figuring out what zip codes the bank was lending to slow it all down.

The Acting Comptroller said that even back then, they would call that the bank got game stopped. Then the bank had a leverage ratio problem. In any case, hope for the best, prepare for the worst. These preparations, as operationally painful as they are necessary to go through them, but the hope is that it helps. It is also good for issue spotting. Again, these are not particular issues that the OCC owns, but it does provide intel to Federal Home Loan Bank and the discount window about things that they can do to operationally make the process better. Because practice makes perfect. That is the kind of thing where that kind of dialogue can be valuable for everybody.

An Advisory Committee member asked the Acting Comptroller what are the biggest two things on his plate right now that would apply in the community bank world? The Acting Comptroller said that he sounds like a broken record, but he always worries about complacency. If banks look at the interest rate environment, for instance, there are some folks now who are saying soft landing, soft landing, soft landing, which sounds great. Where is the market on the credit cycle? This would just be a generalized question. He said that he was in a meeting with bankers recently where there are a number of the more experienced bankers who are a bit more pessimistic about where the industry is in the credit cycle than others.

Those things matter. Like those views matter in terms of not just a bank's business posture, but also in terms of its preparedness. He said that he always wants to make sure that the industry is paying attention to risk management and putting itself through the paces of what if. What if things do not play out the way banks think they are going to play out? What are those impacts on the industry? How are banks and the OCC thinking about it? That is critical. Memories are short. He said that he thinks that even though there was banking turmoil last spring, in some meetings and conversations, it felt like that was like a long, like a distant, distant memory. Happy days are here again, which is okay. The happy days are good.

But banks always want to make sure they are pairing that with appropriate risk management. Particularly in the area of CRE and credit, good old-fashioned credit. These are risks that banks are all familiar with, appropriate risk, credit, plastic, that because there has been a benign cycle for quite some time does not mean that it is going to be benign forever. Last year a lot of bankers rediscovered interest rate risk. That is 101 for the OCC. Same thing for credit, should be 101. So those things are examples of what he thinks about.

He also said that he spends a lot of time thinking about non-financial risk, whether it is compliance, AML, operational, or operational resilience. Those are the areas where the industry lives in a more complicated system now and the bad guys have gotten better. Just keeping on top of that is not easy.

He said that he thinks the banking industry has a comparative advantage relative to others with experience with controls and doing this and being the trusted source. When things go wrong, folks are going to say, well, banks are more trustworthy because they have been at it longer and we have got regulators and supervision. Like there is just more infrastructure around that than in some other industries. It can be a comparative advantage, but that does take work. The OCC is here to engage on those things. If banks have questions or concerns, OCC staff is here to engage on those.

The Acting Comptroller thanked the Advisory Committee members for the thoughtful discussion.

Committee Updates and Business

Ms. Bahin said that the next item on the agenda is committee updates and business. The updates included announcing the tentative dates for the 20206 meetings. The first meeting was scheduled for March the 4th, the second meeting was scheduled to include a Joint Mutual Forum with the FDIC and the Federal Reserve Bank of Boston, for June 9th and 10th. One day would be the committee meeting and the next day would be the Joint Mutual Forum. The final meeting of the year was scheduled for November the 4th. Also, as a reminder the OCC renewed the Advisory Committee charter for another two-year period until the end of June 2026. The agency also solicited nominations for new members and received a great group of possible new members. Staff has started the process, to get all of the background information and approvals completed in time to have a meeting at the beginning of March.

An Advisory Committee member said how much he had enjoyed being on the Advisory Committee. He noted the banker relationships, and the relations developed with OCC staff.

Mr. Brickman said that he would repeat his comments from earlier in the meeting to thank the members who have been on the Advisory Committee for two terms because their insights and participation have truly been helpful to OCC in steering the direction of how the OCC works with the mutual industry and ensures that the agency provides good, clear guidance. There are several things that are still in flight based on commentary that the Advisory Committee members have provided that OCC staff will hopefully be able to bring to a finalization point in the coming year.

He said that he likes to remind members that even though their term on the Mutual Savings Association Advisory Committee is ended, these are public meetings. If they want to come to every single one of those meetings next year, they are more than welcome to dial in as a public member, listen to the economic presentations. They can even throw in some commentary with Mr. Knott if they want to share some jokes back and forth with him when he comes to present.

He noted that he and Ms. Bahin are responsible for thrift supervision at the OCC. That role has evolved significantly since integration back in 2011. But at its heart, they are at the OCC to help the thrift industry with any issues or challenges that arise. He said that while the bank's primary point of contact is the supervisory office, Ms. Bahin and he as the Thrift Supervision Division here at the OCC are always available to answer questions to help connect the dots if they cannot find a piece of guidance that they are looking for, or if they want to provide a suggestion for something that can be improved upon. They are still here and available for the banks, even if they are not member of the Mutual Savings Association Advisory Committee.

He also said that the former members are all welcome to attend the forum next year. Having the entire group of Mutuals come together is fantastic, and we have had a lot of success with former members returning and being active participants in the forum meetings that we hold on an annual basis. For those members who are returning, he said that the agency cannot get ahead of itself because the process has to continue with the Treasury background check and preapproval process, The agency will not announce who is returning and who will be added to the committee for several weeks, if not months. But once announcements have been made staff looks forward to reengaging with members for the next two years. He asked the share any thoughts about future topics for the Advisory Committee.

He said that the format for this meeting can change. Agency staff can bring more topic-specific updates, in addition to the standard, items that have been on the agenda. He said that the only thing that is not ever going to go away is the Comptroller roundtable and some form of economic or financial updates to hear the OCC perspective on the economy and the industry.

But beyond that all, this is kind of a choose-your-own-adventure in terms of developing the agenda and what is the most meaningful for the members to engage in that conversation with staff in this forum. He expressed his gratitude towards those members who will not return to the Advisory Committee next year.

Public Comments

Mr. Brickman asked whether there were any members of the public who would like to make a comment. He said that while the people in the room are thinking about whether they want to make a comment, he asked whether the members of the public who were listening if they wished to make any comments. He asked them to raise their virtual hands and let the event producer recognize them and they could make a verbal comment, or they could type the comment into the chat.

Mike Adelman from the Ohio Bankers League, thanked OCC staff attending the meeting for having this platform. He said that has been useful to get together, to share thoughts. He said that mutual institutions matter, and they are an important part of the Ohio banking landscape.

Joe Pigg from the American Bankers Association echoed Mike Adelman’s comments. He said that it is incredibly helpful to be able to hear the conversation, whether it's credit scores or affordable housing. He said that it helps the ABA to connect and share on Zoom and Mutuals Matter.

Ms. Cole echoed the comments of Mr. Brickman and others about just what a great group the members have been to work with. She said that she personally appreciates the candor that comes out of this group, because it helps us move the ball forward on a lot of issues. She said that she hopes that those of the members remaining on the committee are just as actively engaged and mutuals do matter.

There were no other public comments.

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

Certification

/s/

Michael R. Brickman
Designated Federal Officer

Questions for the Mortgage Discussion as part of October 22, 2024
MSAAC Meeting

General:

- What general issues and concerns are the markets in your geographic footprint experiencing with respect to supply, marketing times, and property type availability?
- Did the recent change in interest rates change the mortgage market activity in your area? Has the change been too recent for any noticeable impact?
- 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?
        - Have the increased prices of insurance had an impact on availability and pricing of houses and mortgages? Have you noticed any impacts on borrowers' continued affordability?
- 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?
    - What is the percentage of first time homebuyers in your originations? Are these borrowers more prone to one program v another?

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 there been a noticeable change 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?
- Has your funding base changed? Did it change as a result of changes you adopted during the pandemic? Are those changes permanent?
- Has the demographic of the borrower changed, for example, are millennials buying homes, are boomers selling their homes and moving to smaller homes or just moving? Are more homes available for first time homebuyers?

- How important is technology to your customers?
    - Are the changes you made during the pandemic to accommodate customers permanent? Do the technology and processes continue to evolve?
    - Have new processes that you developed to accommodate changes in the processing or underwriting of loans evolved further?
- 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?