

Office of the Comptroller of the Currency
Minutes of the Meeting of the
Mutual Savings Association Advisory Committee
April 29, 2014

The Mutual Savings Association Advisory Committee (MSAAC) was convened for a meeting at 8:00 a.m. on April 29, 2014, at the Office of the Comptroller of the Currency (OCC), 400 7th Street SW, Washington, D.C. 20219.

In accordance with the provisions of Public Law 92-463, the meeting was open to the public from 8:00 a.m. to 12:00 p.m.

Advisory Committee Members Present

Martin Connors, David Ferries, C. Alan Horner, Thomas Kemly, Paul Mackin, Martin Neat, Michael Nolan, Margaret Smith, Paul Thompson

OCC Staff Attending

Comptroller of the Currency Thomas J. Curry, Charlotte Bahin, Kimberly Cahill, Arnie Cohen, Kevin Corcoran, Donna Deale, Ralph DeLeon, Donald Dwyer, John Eckert, Philip Gerbick, Gregory Golembe, Jennifer Kelly, Kristin Merritt, Carrie Moore

8:00 a.m.—Public Meeting

Donna Deale, Deputy Comptroller for Thrift Supervision and the committee's Designated Federal Official called the meeting to order and welcomed attendees. Following introductions of the committee members and individuals in attendance for the OCC, she introduced Comptroller Curry.

Comptroller Curry welcomed the committee members and thanked them for their time and commitment.

8:30 a.m.—Discussion With Members

- **Shared Back Office Operations**

Ms. Deale introduced the topic of shared back office operations. A committee member had requested that this topic be on the committee's discussion agenda. Ms. Deale listed some of the opportunities for the sharing of services and asked the committee members whether they had any experience of sharing back office operations with other banks. Several committee members described their experience and highlighted some issues of concern that had arisen in discussions about establishing such relationships. An example of past ventures included the establishment of a shared bureau of appraisers. Another committee member described an effort by several financial institutions to combine resources to share the services of a compliance company. The member described some of the hurdles involved in establishing a consortium type of

arrangement. The concerns included depository institutions of various sizes and charter types sharing the resources of the compliance company and the inclusion of credit unions in the group. Two other committee members discussed using shared resources or excess capacity in the servicing of mortgage loans.

Kevin Corcoran, Assistant Director in the Chief Counsel's Office, Bank Activities and Structure Division, provided some background and described the legal authority under which federal savings associations are permitted to share back office operations. The former Office of Thrift Supervision (OTS) and its predecessor, the Federal Home Loan Bank Board, had looked at the question of whether federal savings associations are permitted to share back office operations in the 1970s and 1980s. The conclusion was that the Home Owners' Loan Act and the rules of the agency permitted such sharing in many circumstances using service corporations or pass-through investment authority. In addition, in 1997 an opinion was issued that permitted a federal savings association to share excess capacity without forming a service corporation.

Ms. Deale asked the committee members what issues concerned them. One committee member asked what would be the agency's reaction to a sharing arrangement. He mentioned the credit union example of a Credit Union Service Organization (CUSO). CUSOs are examples of the types of entities organized to provide shared operations.

Ms. Deale introduced Kimberly Cahill, a National Bank Examiner (Bank Technology Analyst), and John Eckert, Director for Operational Risk and Core Policy, and asked them to talk about the sharing of data processing services and the recently revised third-party guidance. Ms. Cahill described the practice of community banks sharing data processing services by those banks with excess capacity. She said that it is common practice with smaller banks. The bank with excess capacity contracts with other banks. She highlighted the importance of reviewing the third-party guidance with regard to the expectations for the bank purchasing the outsourced services and to the oversight of the relationship. She mentioned that the guidance is applicable to services other than Information Technology (IT) as well. Ms. Cahill also reiterated that each bank must look at the risk of using another bank or any other type of service provider when evaluating whether to enter the arrangement. A bank can minimize the cost of the service by deciding to enter a relationship with another bank but it cannot eliminate the risk of the activity.

Mr. Eckert described the importance of looking at the risk of a third-party relationship from the beginning to the end of the relationship. He said that when planning a third-party relationship it is important to have the termination of the relationship in mind and to explore the contingencies that might arise. He mentioned four critical points to consider: how to protect customer information, how to ensure continued service, the costs of bringing the service in-house and the bank's reputation risk. Mr. Eckert mentioned that third-party relationships historically were IT-centric but that they could involve a variety of activities, including servicing, asset management, and credit.

A committee member asked whether the OCC would be concerned if a federal savings association or national bank collaborated with a non-OCC supervised bank. Mr. Corcoran responded that there are alternate ways of establishing the relationship. Ms. Cahill reminded the committee that if a service provider provides services to a group of banks with different charters,

each of the agencies has the authority to examine the service provider, a joint examination can be done, and the agencies can issue a joint report of examination.

Comptroller Curry asked the committee whether the OCC should pursue additional guidance on shared arrangements and whether it would be of value to federal savings associations generally. Jennifer Kelly, Senior Deputy Comptroller for Midsized and Community Banks, suggested that the OCC prepare a white paper or other document that would look at the compliance, supervisory, and legal aspects of these arrangements. She remarked that such a document would be useful for all community banks. Committee members agreed that a white paper would be useful in understanding the parameters of the alternatives. Philip Gerbick, Senior Thrift Advisor, mentioned that the use of service corporations was prevalent in the 1970s and the 1980s. In fact, the Federal Home Loan Banks had formed data service providers for small federal savings associations. He said that the concepts have not changed but some of the protections against the liability concerns need to be updated. There have been recent discussions with banks and trade organizations about how to establish a single entity or person to do work for multiple banks.

Comptroller Curry mentioned the historical context of the technology gap for many institutions in the 1970s and 1980s and the concerns that have arisen recently with the increased number of compliance requirements. Some issues that need to be addressed include how to structure a contract and ensure value for each bank participating. Ms. Kelly mentioned the value of economies of scale in this context and the need to explore the examples of activities and for agency coordination. Committee members asked about other areas of possible sharing, including servicing.

Comptroller Curry suggested that it would be valuable to look at how and why the CUSO model works. He suggested informal discussions with the NCUA.

Ms. Deale agreed that the concepts have potential and should be explored further.

- **Legislative Developments**

Ms. Deale introduced Carrie Moore, Director for Congressional Liaison, and asked her to give a legislative overview and update. Ms. Moore described the activities of the OCC's Congressional Affairs office. The office monitors developments on Capitol Hill and coordinates with the legislative affairs areas of the other federal banking agencies. The office also provides nonpartisan technical assistance to congressional staff to help them understand the impact of legislative initiatives and achieve their objectives. OCC staff provides education for congressional staff and interacts with congressional members in an effort to keep lines of communication open and avoid legislative surprises. The Congressional Liaison office hosts quarterly brown bag lunches for congressional staff on a variety of topics. In the past year, the OCC testified on several topics in the House and the Senate.

Ms. Moore described the pending bills of interest to the OCC. She described several legislative initiatives that are pending in committees other than those with jurisdiction over the OCC but would affect the operations of federal agencies or financial institutions. For example, a bill that would require additional cost/benefit analysis in rulemaking might limit the ability of all

agencies to issue rules. Another example of broad legislative initiatives that might affect the banking industry is a group of bills introduced to address cyber security, data breaches, and data sharing. Other initiatives that the OCC staff is following include legislation to address concerns about “too big to fail” and the future and structure of the government-sponsored enterprises (GSEs).

Ms. Moore turned to the Rothfus bill that was introduced in March and to the Grimm bill introduced last year. Both of these bills create a mutual national bank charter and have other features. She discussed the legislative forecast of the bills and explained that there is not much time left before the end of the legislative session for action on these bills—indeed, on any of the bills pending before the banking committees—to occur. There may be discussions about the bills but committee or floor consideration is unlikely. Committee members asked about OCC reaction to the bills that focus on mutuals and the GSE bills. A committee member urged the OCC to look hard at the mutual-focused bills and suggested that some provisions could be included in a broader community bank bill. The issues of capital for mutuals and the organization of mutual holding companies were highlighted in the discussion. With regard to the GSE legislative debate, in addition to the ability of mutuals to sell loans to the GSEs, there is concern about the impact of any legislation on the operations of the Federal Home Loan Banks. Ms. Moore reiterated that these concerns are examples of why the OCC staff stays in close contact with congressional staff.

- **Compensation/Phantom Stock Plans**

Ms. Deale introduced the topic of compensation and the ability of mutuals to adopt phantom stock plans. She said that the topic comes up frequently when either she or Ms. Kelly speaks with groups of bankers and when a question is asked about the rescission of OTS Regulatory Bulletin 27b. Ms. Deale asked the committee members whether there is a gap in the OCC guidance on compensation. A committee member responded that any guidance on compensation that can be given to the boards of directors of mutuals would be welcomed. The competition for talented employees is tough for mutual institutions, in particular because they are unable to offer any equity compensation.

Mr. Gerbick responded that any OCC guidance on compensation would not be overly prescriptive. The current guidance supports that compensation given by banks of all charter types be used to attract, develop, and retain talented employees. Compensation and management succession have become supervisory concerns. There is a perception that a generation has been skipped in the development of employees able to succeed current management. Phantom stock plans and other types of incentive compensation may address some of the issues at mutual institutions. Any compensation program at a well-run company has to balance the risk of the activities of the employee with the reward of the compensation. The federal banking agencies are working on the rule that will implement section 956 of the Dodd-Frank Act. This section of Dodd-Frank requires that the agencies issue a rule or guidance on incentive compensation for institutions with assets of \$1 billion or more.

Mr. Gerbick explained that the best guidance is the December 2010 interagency guidance and three former OTS rules: 12 CFR 170, which addresses safety and soundness generally and has a provision on compensation; 12 CFR 163.39 – employment contracts; and 12 CFR 163.161(b) –

management and financial policies. He described these documents as not prescriptive but not permitting unsafe or unsound compensation practices. Mr. Gerbick described the 2010 interagency guidance on incentive compensation. The guidance reinforces that incentive compensation practices at insured institutions should be reviewed for balance and supported by strong corporate governance practices. The guidance describes the expectation that the board of the directors be involved in establishing compensation plans and policies. Mr. Gerbick acknowledged that the guidance is not a regulation and explained that an institution's compensation policy should be structured based on the size and complexity of the bank and tailored to the risk of the institution. The guidance is intended to provide flexibility. The OCC handbook that covers compensation looks at the same issues as the regulations.

Mr. Corcoran provided some background on the former OTS guidance regarding phantom stock plans. The guidance was rescinded as part of the policy integration process but not because of the reference to phantom stock. The rescinded guidance stated that phantom stock plans were appropriate if they were established in a safe and sound manner. He mentioned that a small number of banks have these types of plans. A committee member described the plan that his bank had adopted as an employee retention tool. He described an equity appreciation rights plan for which the board of directors grants phantom shares that are tied to the profitability of the bank. The formula for granting the shares is tied to the employee's salary and vesting is over 10 years. The plan provides a combination of deferred compensation, phantom stock, and golden handcuffs. Directors participate in the plan as well as employees. Ms. Deale asked the committee members whether others had plans similar to this example.

In response to a question from Comptroller Curry, committee members discussed the value of the plan and how hard it was to establish and administer. It was observed that this type of plan is more important for older employees than for younger ones. There are variations in how these plans are established and with which measures the value of the phantom stock is calculated. Finally, there are administrative and accounting concerns.

Another committee member addressed the content of the OCC guidance and asked whether it addresses mutual compensation issues directly. He suggested that it would be helpful to have statements that address mutuals specifically. He mentioned that a discussion of cash bonus plans would be helpful for boards of directors trying to establish compensation plans.

In response to a question about how frequently compensation become a supervisory concern, Mr. Gerbick replied that excessive compensation is not often a concern but that smaller institutions may have trouble hiring employees as part of a succession plan. In the past, mid- to senior-level hiring was frequently done from larger institutions; currently, this is not the case. An excessive level of compensation is something to be aware of when competing for employees. A committee member suggested that larger institutions need to have more sophisticated employees and that larger institutions may compete with public companies for employees.

Committee members agreed that management succession is a concern for all community institutions, not just mutuals. Mr. Gerbick described generally what the OCC looks for in a management succession plan and when a matters requiring attention (MRA) is included as part

of a report of examination. Ms. Kelly reiterated that it is a problem for many community banks and asked what the OCC can do to assist community banks.

There was additional discussion about how the OCC determines that compensation is excessive. Other compensation rules were mentioned. For example, the recently issued mortgage loan originator compensation rules and their impact was discussed.

- **Rules Integration**

Ms. Deale described the process being used to integrate the rules and policy guidance issued by the former OTS into the rules and guidance of the OCC. In the three years since the transfer of responsibilities from the former OTS to the OCC, many of the booklets in the *Comptroller's Handbook* have been revised to eliminate duplication and to include regulatory citations applicable to both federal savings associations and national banks. The rules of the former OTS have been moved into the 100 series of rules in title 12 of the Code of Federal Regulations and renumbered. Generally, the only changes made in this process were changes to citations and other non-substantive revisions. There is an ongoing project to substantively integrate the former OTS rules with the OCC rules. Some of the rules have been integrated as required changes have been made. For example, the lending limits rules and the flood insurance rules have been integrated while making statutorily required changes. Ms. Deale asked the committee members whether the integration of the guidance and rules was working and whether the communication about what guidance and rules are applicable to which institution charter type is clear. A committee member stated that the communication process had gone smoothly. Staff at his bank felt comfortable with what had been issued, he said. Other committee members agreed. The communication has been good, but it needs to continue.

Ms. Deale continued and described a change to the process to be used to integrate the former OTS rules. Because of the beginning of the decennial regulatory review required by the Economic Growth and Regulatory Paperwork Reduction Act (EGRPRA), the integration of most of the rules will be postponed until the end of the review. The exception is the rules issued to implement the licensing or application requirements. A proposal will be issued to revise the licensing rules at about the same time that the first EGRPRA request for comments will be issued. The first EGRPRA request for comments will seek comments on the existing licensing rules. Any comments received in response to either the first EGRPRA request for comments or the proposal to amend the licensing rules will be considered when OCC staff develops a final rule. Ms. Deale asked the committee members to consider what differences between the treatment of national banks and federal savings associations are important to retain in the licensing area.

- **Joint Forum With FDIC**

A joint Federal Deposit Insurance Corporation (FDIC) and OCC forum for mutual institutions will be held in Washington on July 24. A committee meeting will be held the afternoon of July 23. There will be a reception the evening of July 23 for those bankers already in Washington. The OCC has sent invitations out to federal mutual savings associations and to mutual holding companies. The FDIC will send invitations to mutual savings banks and mutual state savings

associations. The agenda was developed collaboratively with the FDIC. The agenda includes an opening dialogue with the Comptroller of the Currency and the Chairman of the FDIC; an economic presentation; a panel with the agencies' Ombudsmen; a panel on cybersecurity; a panel on branding for the generational shift; a panel on compliance; lunch roundtable discussions; and a supervisory and legal discussion. In response to a question from Ms. Deale about what other topics should be included, a committee member requested that an update on the two bills of interest to mutuals be provided.

Member Roundtable

Each committee member shared thoughts on issues faced by mutuals and community banks in general. Common themes included the following:

- Competition from credit unions and larger financial institutions
- Regulatory burden
- Implementation of new rules including the Volcker rule
- Financial Accounting Standards Board's current expected credit loss impairment project
- Cybersecurity and data breaches
- Succession planning
- Third-party vendor management
- Stress testing
- Interest rate risk
- Examination efficiency for small banks

Future Meetings and Charter Renewal Process

Kristin Merritt, Special Counsel in the Chief Counsel's Office, Administrative and Internal Law Division, provided an overview of the charter renewal process. The committee charter expires in 2014 and must be renewed. Further, Ms. Merritt described the nomination process for the new members of the committee. A notice soliciting nominations for new members will be published in the *Federal Register* in early June 2014 with a response due date of mid-July 2014. Ms. Merritt described the membership balance requirements. Ms. Deale observed that existing members could be renominated.

Ms. Deale said that the last meeting of the committee with this group of members would be in November 2014 in Washington.

Public Statements, Wrap-Up, and Adjournment

No public statements were submitted in advance of this meeting.

Comptroller Curry and Ms. Kelly each thanked the committee members for their participation and involvement and reiterated how valuable their participation is to the OCC.

Ms. Deale adjourned the meeting.

Certification

Donna M. Deale
Designated Federal Official