Community Banking in 2023

Overview . . .

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Current Economic Conditions

Continued Inflation

Slow supply chain fixes

Crazy money supply

Deteriorating unemployment

Curve Inversion

Weak GDP

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- Inflation that not only isn’t transitory, but will likely remain into 2023, fueled by
- Continued Supply Chain Disruption in all sectors plus a
- U.S. Debt/Deficit that is surging and which politicians want to take even higher fueled by
- Staffing shortages due to lack of qualified workers propelled by
- Tapering, now downsizing, by the Fed decreasing demand and which combined will drive
- Rising Rates which will dampen
- Consumer demand, which was very robust, all combined will
- Slow GDP growth and probably lead to Recession, if not in one already.

This can all be exacerbated by:

- Black/Green Swan Events or stupid tax policy
  - Ukraine is one Black Swan event
  - Taiwan, Iran and North Korea could be others

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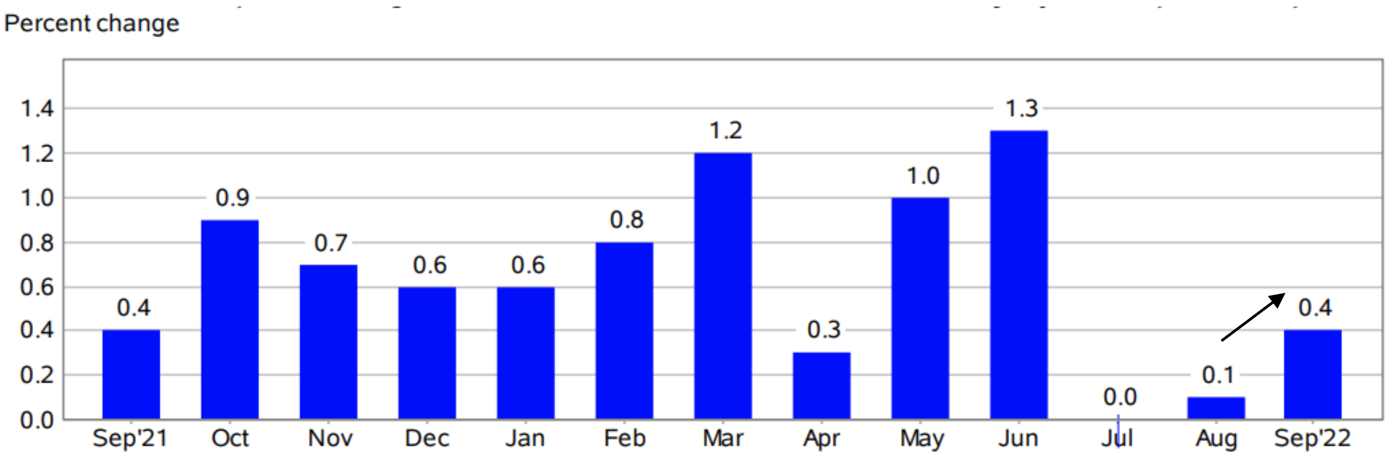
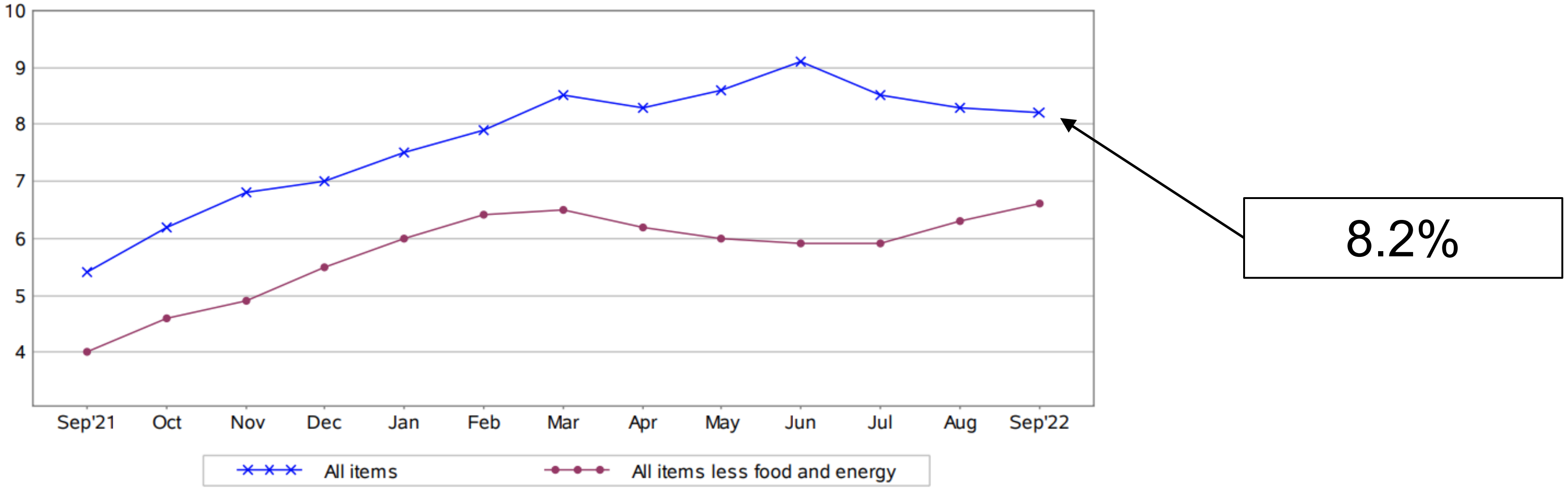
Inflation (CPI-U) index rose 0.4 percent in September after only rising 0.1 percent in August. Over the last 12 months, the all-items index increased 8.2 percent . . .





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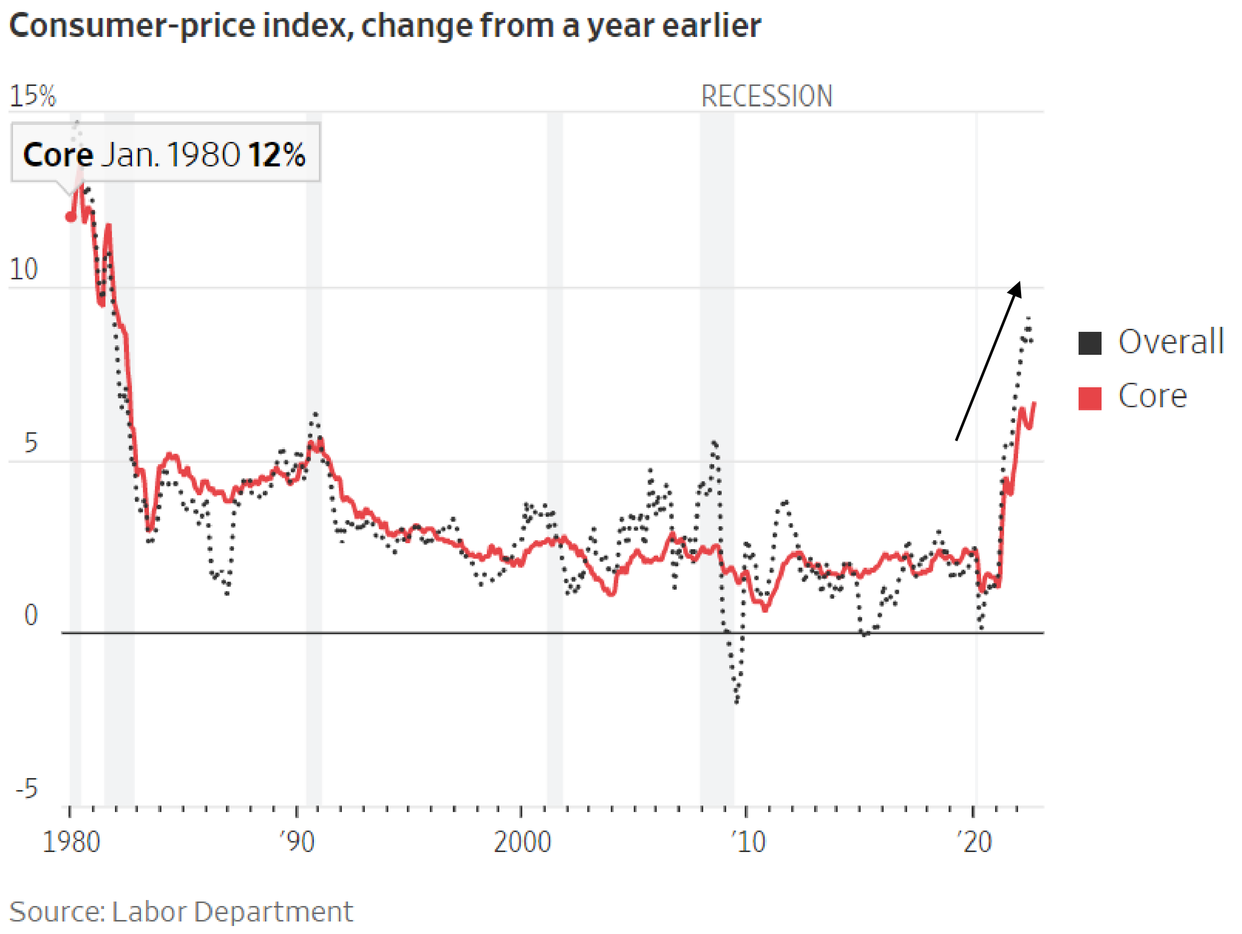
Source: BLS, October 13, 2022

There will be a rising and "persistent" inflation throughout 2023 . . .



Source: WSJ, October 13, 2022

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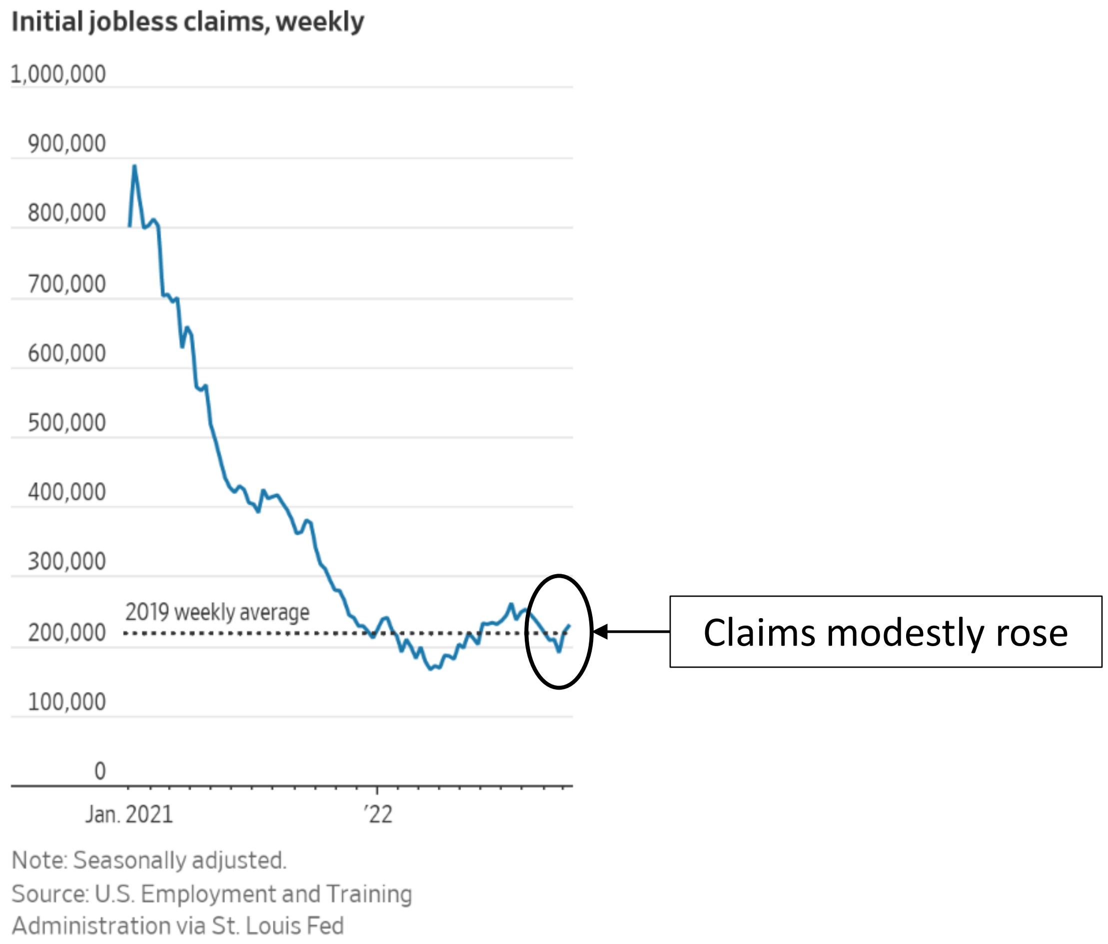
The U.S. job market remains on strong footing but has cooled in recent months . . .



Source: WSJ, October 13, 2022

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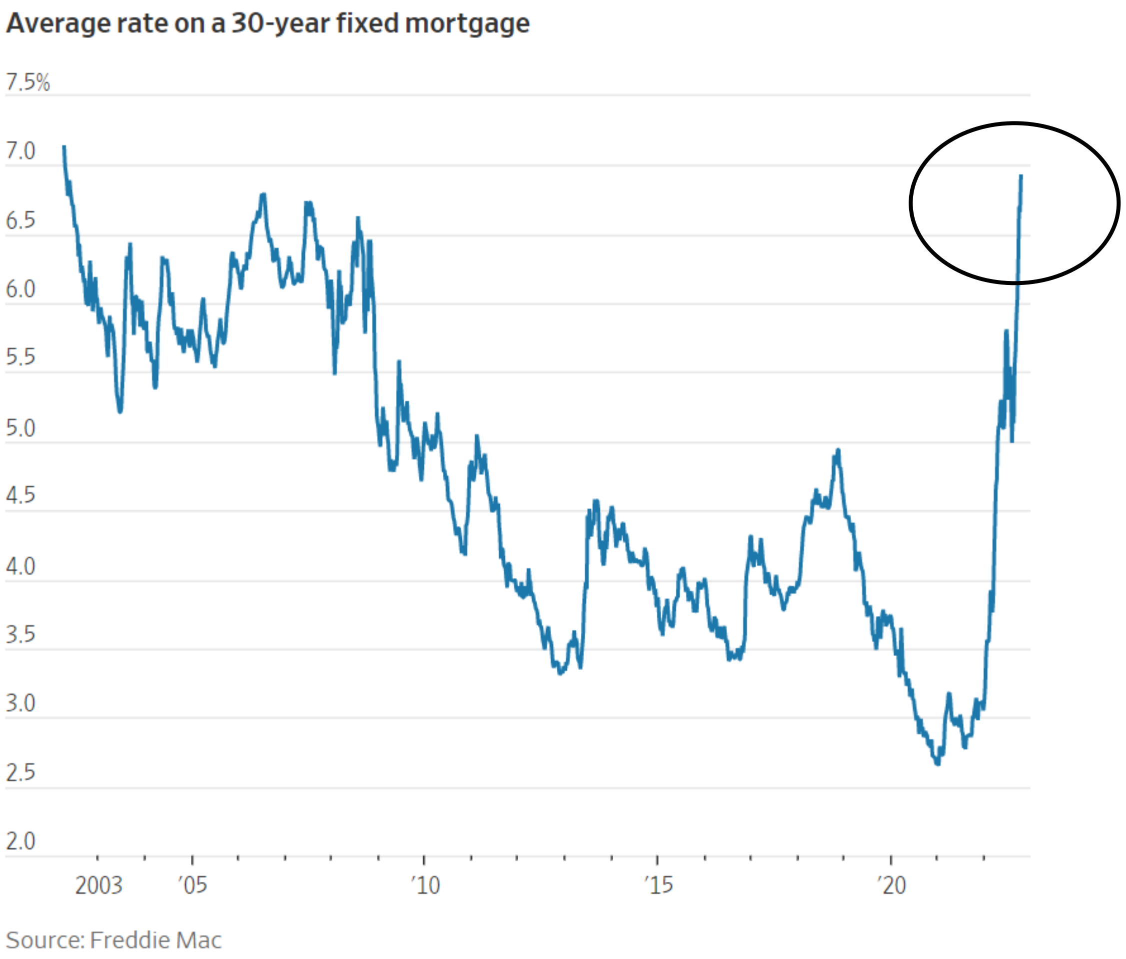
Today’s average rate on a 30-year fixed mortgage is 6.92% (a 20 year high). The peak pre 2003 mortgage rate was 7.10% . . .



Source: WSJ, October 13, 2022

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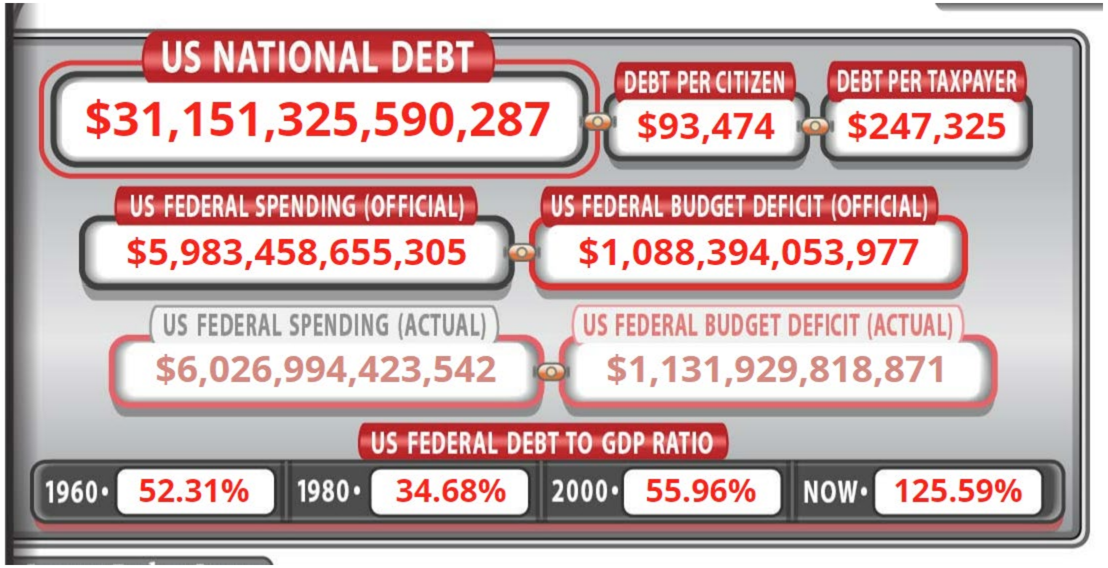
How much debt can the U.S. handle?



The debt clock shows U.S. Debt at $31.2 trillion. The deficit this year will exceed $1.4 trillion, not including the Democrat great giveaway. Every taxpayer owes $247,325.

Data as of 8/31/22
Source: CRFB; FRED

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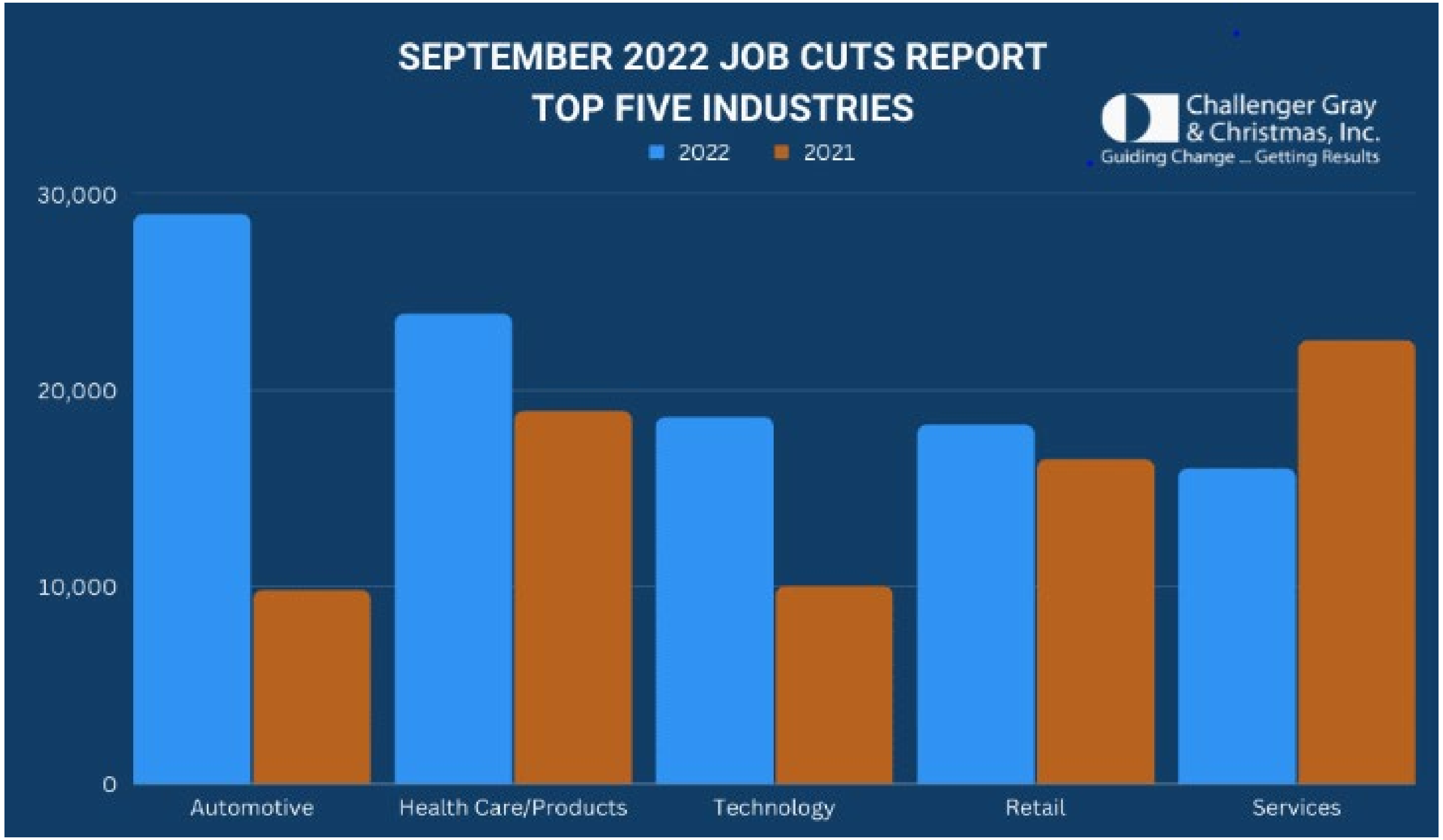
- U.S. based employers announced 29,989 job cuts in September, a 46.4% increase from August. A stunning 67.6% higher from the same month last year.
- September marked the fifth time this year that job cuts were higher in 2022 than in the same month a year ago.
- Organizational layoffs
  - Intel laying off thousands of workers amid a slowdown in PC sales.
  - Beyond Meat is cutting 19% of its workforce.
  - Meta is also reportedly cutting workers.
  - Other tech companies began cuts or hiring freezes earlier this year.

The Automotive sector led all industries in job cuts this year with 28,922, up 194% from the 9,831 cuts announced through September last year . . .

- These are five top industries experiencing job cuts over the past year.



Source: MSN, October 14, 2022

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What are the root causes of this workforce problem?

1. Boomer retirements
2. Overall dissatisfaction in workplace – Resignations
3. Lack of skilled workers, caused in part by excessive artificial requirements
4. Remote Work, work from anywhere
5. Quiet Quitting

The real questions are:

1. Will the employment participation rate go back up to normal levels?
2. Are the unemployed systemic?

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Data as of 8/31/2022;
Source: US Debt Clock, FinPro

The equity markets, although recovering, are still down 17% for the year . . .

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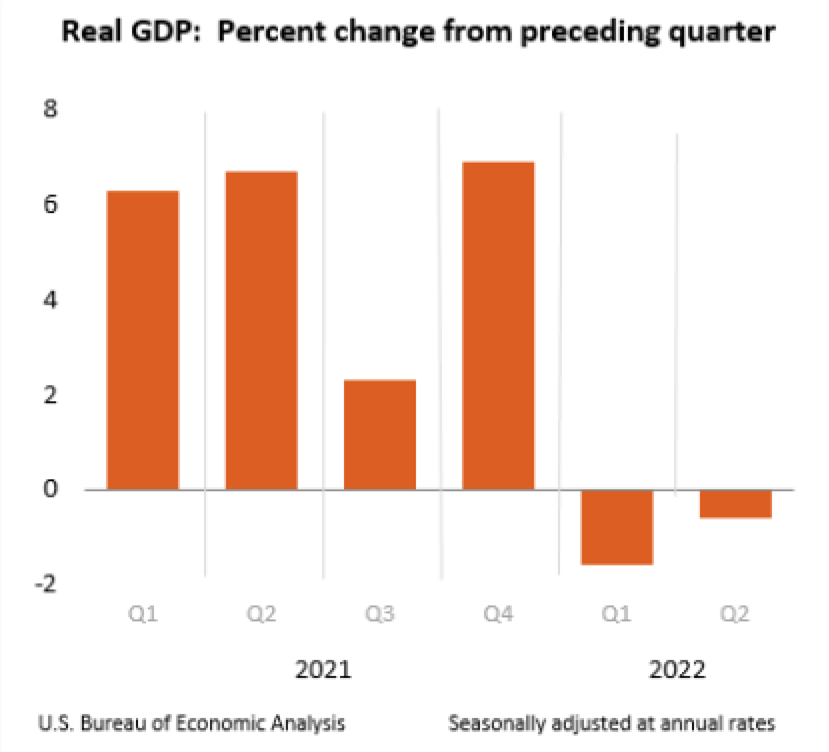
Source: CNN Business.com

When will GDP recover?



3rd Quarter Estimate 1 - .3%

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Data as of 8/31/22
Source: CRFB; FRED, US BEA

1. Track inflation, consumer spending, U6 unemployment and the 10 Year Treasury Rate to determine future path of economy
2. Do a stress test prior to considering selling your under-water investments today – it is a paper loss don't make it real.
3. Do put any new long duration investments into HTM.
4. Plan for potential growth economy and economic downturn scenario
   a) Add a -200 bps rate shock to your ALCO analytics (likely add a -300 bps rate shock in late 2022)
   b) Take a hard look at your organizations beta and decay rates and stress test them
   c) Make a plan for deposit mitigation now
5. Watch for asset bubbles
   a) Automobiles
   b) Residential Real Estate
   c) CRE – Likely in urban markets
   d) LOCs
   e) Agriculture
6. Loans will be hard to come by in 2023 and prepayments will slow to a crawl
7. Remember 5-5-5
   - Fed will raise ST rates to 5.00% to
   - Drive Unemployment up to 5.00% and to
   - Get inflation below 5.00%

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Technological Environment

More severe Cyber threats

Finish move to cloud

End of oligarchies

Automation over people

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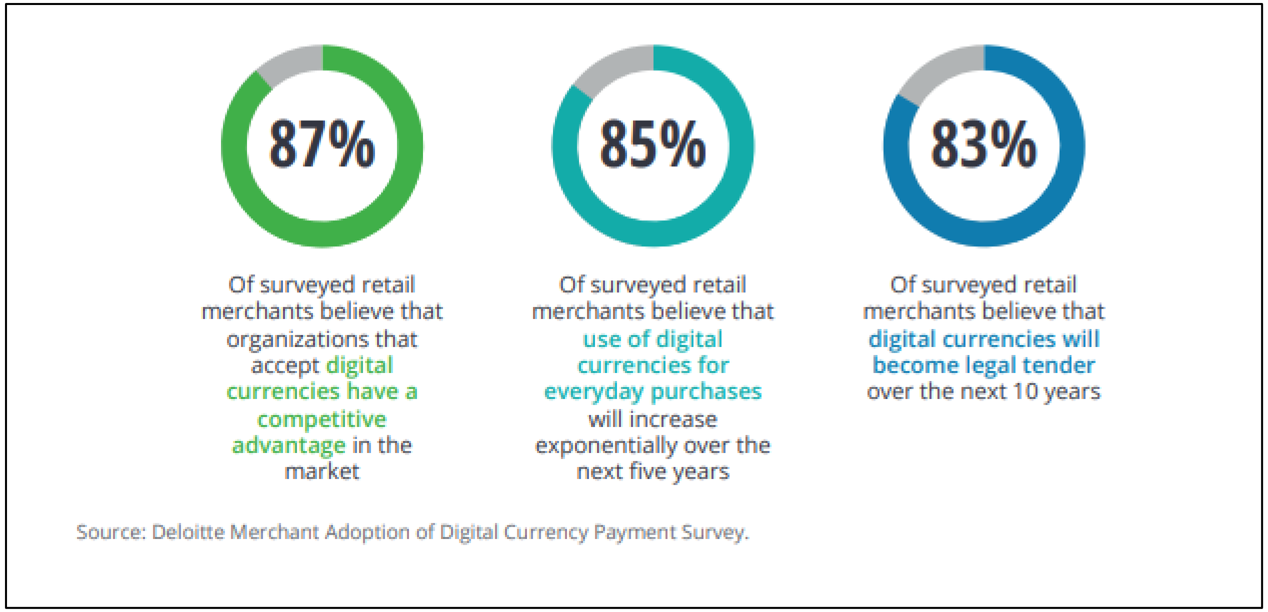
- FedNow Initiative is a new instant payment platform the Federal Reserve Banks are launching in 2023.
  - Will provide financial institutions of every size and in any location across the nation
  - Access to safe and efficient instant payment services in real time, 24 hours a day

- According to a recent survey, merchants are highly in favor of this digital currency payment platform.



Source: Deloitte Survey
Board of Governors Federal Reserve.gov, October 12, 2022

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Similarly, to ATMs, more digital channels are becoming available as delivery channels to banking customers . . .

Source: i-scoop website, 2022

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The rise of digital transformation is linked to significant cost savings utilizing cloud computing . . .

- 62% of financial services workers now use digital workers—software robots— for tasks such as sorting, classifying data, digital data entry, flagging issues, and administrative tasks.

- Deloitte and Fortune also surveyed CEOs about their leadership through the pandemic and 85% indicated that their organizations had significantly accelerated digital transformation during the crisis.

- Another survey showed that nearly 95% of respondents said use of the cloud would reduce both setup and maintenance costs, and nearly 50% stated that their IT costs could drop up to 50% by implementing cloud apps and infrastructure.

- Some of the many ways "cloud" adoption can drive cost savings include:
    - Hardware needs are the responsibility of the vendor; no expensive in-house equipment.
    - Reduced labor and maintenance costs.
    - Increases and workforce productivity; add more cost savings.
    - Cloud solution are easy to use; reducing employee training time and adaptation use.

Source: Deloitte and Forbes Digital Transformation Survey, April 2022
Perle Industry News, May 2022

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Cyber Attacks . . .

1. Effective April 1, 2022, FDIC/OCC/FRB new cyber security notification rules
2. Rules mandate increased cyber security practices, evaluation of breaches and reporting of “notification incident” within 36 hours
3. “Notification incident” is “computer security incident,” which materially disrupts or degrades:
   - ability to carry out operations / delivery of products to material portion of customers,
   - business line and would result in material loss of revenue, profit or franchise value, or
   - failure of operations would pose threat to US financial stability
4. CSI is occurrence that results in “actual harm to the confidentiality, integrity or availability of an information system” or “the information it processes or stores” – provides non-exclusive list
5. Focus on “increase in enforcement actions and fines”
6. New rules do not specify reporting to customers (but you may need to)
7. Notes Board’s responsibility for oversight and need for proactivity

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Technology actions for consideration . . .

1. Like ATMs, Digital is a delivery channel – not a growth channel
2. Prepare for FedNow early, coming in March 2023
3. Ensure you cyber is state of the art
4. Don’t allow your core contracts to go long or contain large prepayment penalties
5. Build, and have ready, a cyber response plan
6. Prepare for a revolution in technology

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Staffing Environment

Resolution of work from office vs work remote

Less but more qualified workers

Scaling back of benefits

Addition of required education credits

Succession to a new level

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- Some key statistics that show more and more workers want employers to help them learn and grow:

  - 57% of U.S. workers want to update their skills, and 48% would consider switching jobs to do it.
  - 80% of workers say they consider professional development and training offerings to be important when evaluating a new job opportunity.
  - 71% of workers say job training and development increase their job satisfaction.
  - 61% say upskilling opportunities are an important reason to stay at their job.
  - 91% of employees want more training opportunities from their employers.
  - 94% of workers would stay at their company if their company invested in their careers.

Source: intellezy.com, September 7, 2022

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- Diversity, equity, and inclusion (DEI) have become key indicators to identify which organizations are considered employers of choice.
- DEI is defined as:
  - **Diversity** refers to people's "race, gender, religion, sexual orientation, ethnicity nationality, socioeconomic status, language, (dis)ability, age, religious commitment or political perspective."
  - **Equity** promotes "justice, impartiality, and fairness within the procedure, processes, and distribution of resources by institutions or systems.
  - **Inclusion** ensures people of all diverse backgrounds are welcome and have a seat at the table. This involves giving all employees the power to weigh in on important decisions and participate in development opportunities.
- Combined, DEI involves creating a place where everyone is welcome, supported, and has the resources they need to grow and thrive regardless of identity, origin, or difference in circumstances.
- Employers typically achieve DEI goals by creating a DEI strategy to develop best practices and track their progress.

Source: US Chamber of Commerce, April 12, 2022

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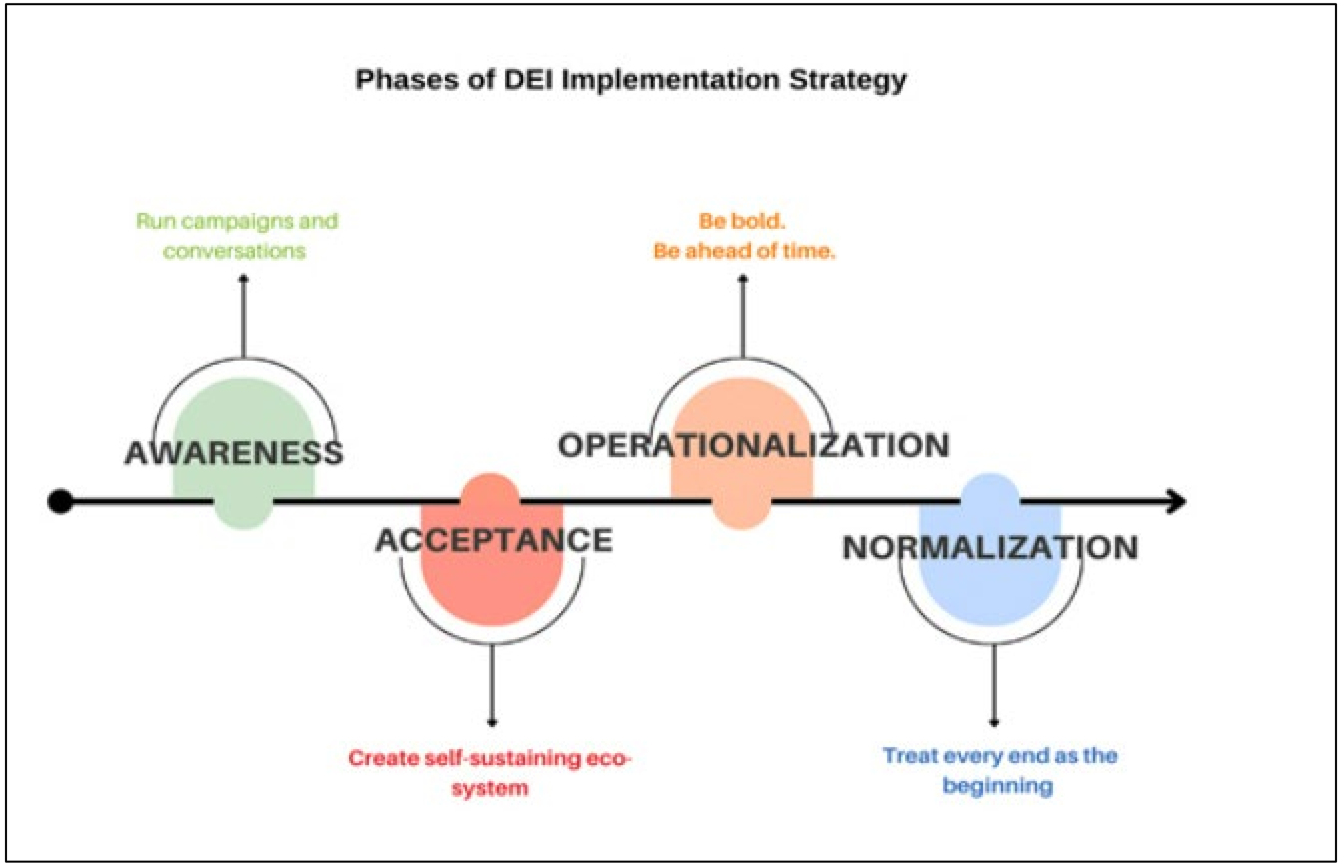
There are four phases of DEI Implementation Strategy . . .



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Source: SHRM.com, September 19, 2022

Staffing issues are getting bigger and harder to solve . . .

- Remote Work
- Rising Compensation
- Education/Training

WHY?

1. 2 Income families have become 1 income families
2. Early retirements up dramatically
3. Peak of Baby boomer Retirements
4. People like getting paid not to work
5. Employees are Quietly Quitting

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According to a recent Gen Z and Millennial survey, "The Great Resignation" will continue into 2023 . . .

Last year's survey revealed that nearly **one in four millennial respondents planned to leave their jobs within the year**, effectively anticipating the Great Resignation.

This year's survey connected with millennials and Gen Zs amid this period of high voluntary job turnover. It found an **increase in loyalty across both groups, potentially because many people changed jobs over the last year**. This year millennials are more likely to say they expect to stay beyond five years rather than leave within the next two.

Gen Zs

	2021		2022
Stay beyond 5 years	21%	↑	23%
Leave within 2 years	53%	↓	40%

Millennials

	2021		2022
Stay beyond 5 years	34%	↑	38%
Leave within 2 years	36%	↓	24%

But the Great Resignation may be with us for a while. Four in 10 Gen Zs and nearly a quarter of millennials would like to leave their jobs within two years, and roughly a third would do so without another job lined up, signaling significant dissatisfaction levels.

Source: The Deloitte Global 2022 Gen Z and Millennial Survey, October 2022

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Empowering people across an organization helps foster a more inclusive environment.

Of the 52% of Gen Zs and millennials who feel empowered to drive change within their organizations, **89% of Gen Zs and 90% of millennials** say they feel a sense of belonging.

When people feel their voices are heard, they tend to feel more connected and loyal to their organizations.

Among Gen Zs and millennials who *feel empowered*

Stay beyond 5 years	66%	65%
Leave within a year	38%	33%

Among Gen Zs and millennials who *don't feel heard*

Stay beyond 5 years	24%	25%
Leave within a years	47%	54%

Source: The Deloitte Global 2022 Gen Z and Millennial Survey, October 2022

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1. KEY IS RELATIONSHIPS
   a) Spheres of influence
   b) Friends, Neighbors, Relatives and Business Acquaintances
2. Strengthen your succession plans for both Management and the Board
3. Enhance your training and education programs
4. Perform a Talent Analysis
5. Consider hiring outside the industry, we need an influx of new thought
6. Examine pay scales, remote work policy and flexibility platforms

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AOCI

Accumulated Other Comprehensive Income

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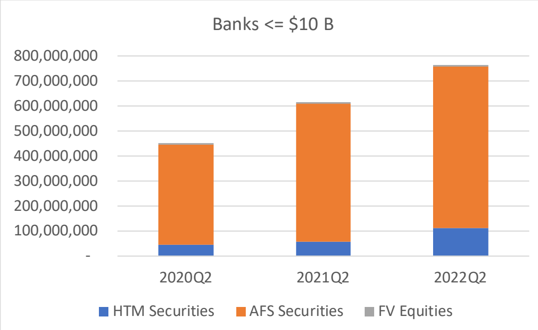
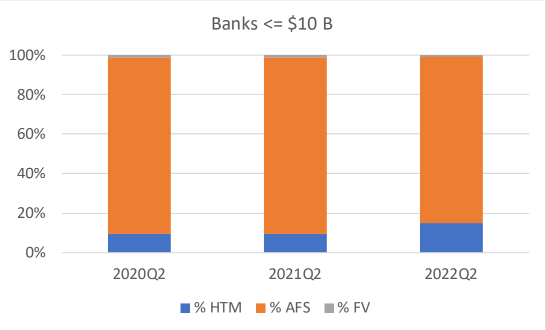
Banks with less than $10 billion in assets continue to hold too much of their portfolio in AFS with nearly 85% still in AFS whereas the banks over $10 billion in assets reduced AFS holdings from 77% to 52% over the past two years . . .

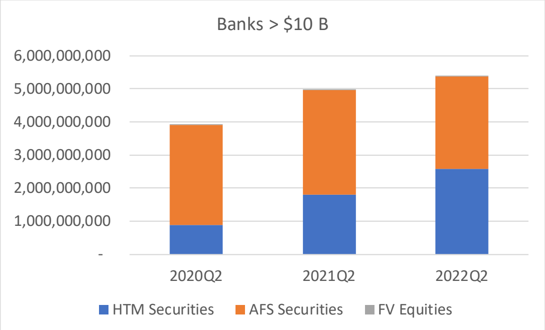
Banks <= $10 billion Assets

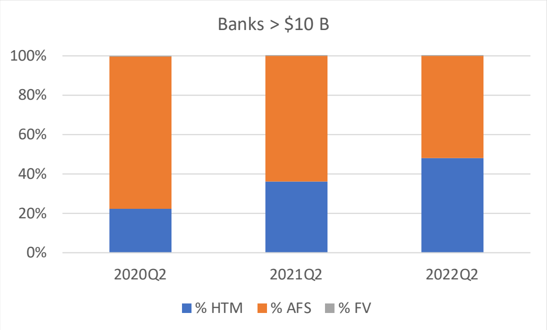




Banks <= $10 B ($000s)	2020Q2	2021Q2	2022Q2	Growth
HTM Securities	43,108,677	57,475,568	111,792,621	68,683,944
AFS Securities	401,048,347	549,802,607	644,332,771	243,284,424
FV Equities	4,950,821	6,340,487	5,370,319	419,498
Total	449,107,845	613,618,662	761,495,711	312,387,866
% HTM	9.60%	9.37%	14.68%	5.08%
% AFS	89.30%	89.60%	84.61%	-4.68%
% FV	1.10%	1.03%	0.71%	-0.40%
Total	100.00%	100.00%	100.00%	0.00%

Banks > $10 billion Assets





Banks > $10 B ($000s)	2020Q2	2021Q2	2022Q2	Growth
HTM Securities	876,195,936	1,795,377,170	2,580,384,383	1,704,188,447
AFS Securities	3,022,083,461	3,156,519,321	2,788,949,968	(233,133,493)
FV Equities	13,078,228	8,358,330	5,561,655	(7,516,573)
Total	3,911,357,625	4,960,254,821	5,374,896,006	1,463,538,381
% HTM	22.40%	36.20%	48.01%	25.61%
% AFS	77.26%	63.64%	51.89%	-25.38%
% FV	0.33%	0.17%	0.10%	-0.23%
Total	100.00%	100.00%	100.00%	0.00%

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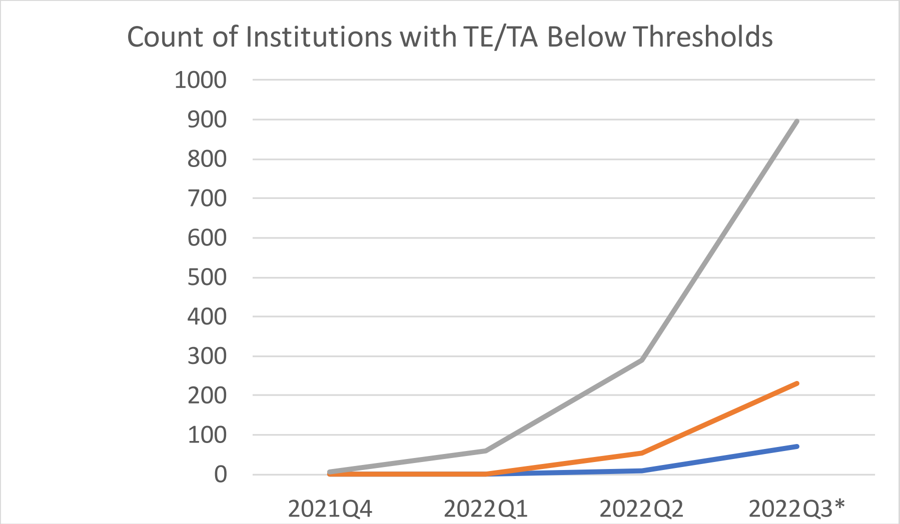
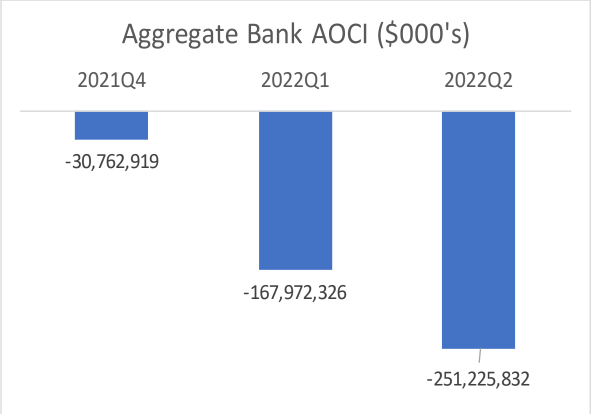
As a result of the significant rate rise, AOCI has declined dramatically and has decreased tangible equity to tangible assets ratios . . .

- **As of March 31, 2022:**
  - There were 0 banks with negative tangible equity. This number equates to 0.00% of the industry.
  - There was 1 bank with tangible equity to tangible asset ratios below 2%. This number equates to 0.02% of the industry.
  - There were 59 banks with tangible equity to tangible asset ratios below 5%. This number equates to 1.25% of the industry.
  - AOCI was -7.54% of total bank capital
- **As of June 30, 2022:**
  - There are 10 banks with negative tangible equity. This number equates to 0.21% of the industry.
  - There are 43 banks with tangible equity to tangible asset ratios below 2%. This number equates to 0.91% of the industry.
  - **There are 236 banks with tangible equity to tangible asset ratios below 5%. This number equates to 4.99% of the industry.**
  - AOCI is -11.54% of total bank capital
- **Projected Next Quarter***:
  - There could be 71 banks with negative tangible equity. This number equates to 1.50% of the industry.
  - There could be 160 banks with tangible equity to tangible asset ratios below 2%. This number equates to 3.39% of the industry.
  - **There could be 666 banks with tangible equity to tangible asset ratios below 5%. This number equates to 14.09% of the industry.**
  - AOCI could be -15.37% of total bank capital



TE/TA	2021Q4	2022Q1	2022Q2	2022Q3*
Banks with <= 0%	0	0	10	71
Banks with <= 2%	0	1	43	160
Banks with <= 5%	5	59	236	666



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Building value together
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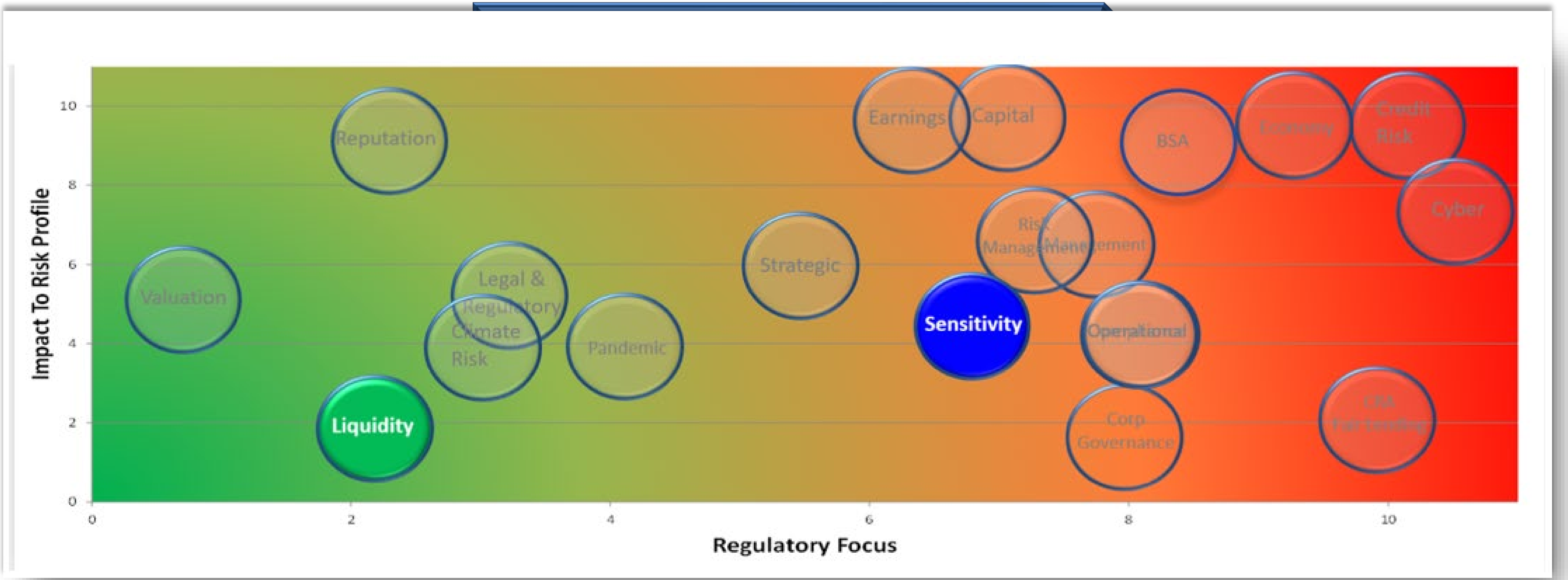
* Note in order to calculate the projected ratio the following assumptions were made:
- Projected Tangible Equity = Q2 equity – Q2 intangible + Q2 change in AOCI + average quarterly income from prior 3 quarters
- Projected Tangible Assets = Q2 assets – Q2 intangibles + Q2 asset growth

Home

CAMELS+ Component Trend: Rising market rates will continue to bring the liquidity and sensitivity components to the forefront of the regulatory examination process . . .

2022 and beyond



The chart above illustrates the CAMELS+ components and the overall regulatory focus on each component. Over time, each of these components shift based upon the overall projected banking environment.

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Liquidity Concerns . . .

- Based upon recent discussions with the primary federal regulators, the following will likely occur:
  - At 5% Tangible Equity to Tangible Asset Ratio – Regulatory Comments
  - At 2% Tangible Equity to Tangible Asset Ratio – Potential Regulatory Order
  - As a reminder if a Bank is deemed "less than well capitalized" (which could occur if a bank gets a consent order):
    - High Rate Deposits (deposits above local or national rate cap) and Brokered Deposit Capacity will be removed.
    - Listing Service Deposits are currently below the national rate cap so they are not deemed high rate. Could the regulators limit the use of listing service deposits?
  - On balance sheet liquidity reduced if each investment that has a market value below 90% of book value. FinPro is going to try to recommend a lower percent to the regulators.
- Based upon recent discussions with the FHLB, the following will likely occur:
  - At 0% Tangible Equity to Tangible Asset Ratio – pull borrowing availability

Monthly Rate Cap Information as of September 19, 2022

Deposit Products [1]	National Deposit Rates [2]	National Deposit Rates Rate Cap Adjusted	Treasury Yield [3]	Treasury Yield Rate Cap Adjusted	National Rate Cap
Savings	0.17	0.92	2.33	3.08	**3.08**
Interest Checking	0.04	0.79	2.33	3.08	**3.08**
Money Market	0.18	0.93	2.33	3.08	**3.08**
1 month CD	0.07	0.82	2.40	3.63	**3.63**
3 month CD	0.15	0.90	2.96	4.30	**4.30**
6 month CD	0.34	1.09	3.32	4.73	**4.73**
12 month CD	0.60	1.35	3.50	4.95	**4.95**
24 month CD	0.64	1.39	3.45	4.89	**4.89**
36 month CD	0.66	1.41	3.46	4.90	**4.90**
48 month CD	0.63	1.38	NA	NA	**1.38**
60 month CD	0.74	1.49	3.30	4.71	**4.71**

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AOCI actions to consider . . .

1. Ensure ALCO process and assumptions are accurate and defendable
   - Stop the Check the Box Mentality
   - Don't stop at Static Go Dynamic
2. Run Individual Investment and Portfolio Stress Tests
   - On balance sheet results
3. Determine Resultant TE/TA Ratios
4. Proactively run Liquidity analytics (Contingency Funding Plans)
   - Cash
   - Unpledged Securities
   - Off Balance Sheet (brokered, listing service and borrowing capacities)
   - Test of liquidity sources (Remove Investments at 10% or greater loss)
   - Calculate all four liquidity ratios (cash, + on balance sheet, + borrowing capacity, + other wholesale capacity)
   - Stress Test Liquidity -Especially under the less than well capitalized scenario
5. Determine Impact of move from AFS to HTM
6. Selectively move individual investments from AFS to HTM (longer duration should be the focus)
7. For new Purchases:
   - Greater than 18 months = HTM
   - Less than 18 months = Either way

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continued . . .

8. Expand borrowing capacity
   - Repo lines
   - Fed Discount window
9. For existing portfolio
   - If TE/TA ratio forecast > 5.00% do nothing extra – continue to monitor
   - If TE/TA ratio forecast < 5.00% but > 2.00% move to HTM
   - If TE/TA ratio forecast < 2.00% but > 0.00% move to HTM, Call FinPro to meet with Regulators
   - If TE/TA ratio forecast < 0.00% Call FinPro to meet with Regulators
10. Ensure no OTTI issues
    - Corporate Bonds
    - Exotic CMOs and Other Exotic Investments
11. Other Strategic Decisions
    - Determine if slower growth or shrinkage is required
    - Need to raise capital
    - Document a plan of action - control the narrative to investors and regulators

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2023 Bank Expectations

Much slower balance sheet growth

Weakening loan demand in 2023

Worsening asset quality, led by auto and residential real estate

ACL/ALLL holding at 1.50%

Flat deposit demand

Growing utilization of wholesale funding

Strong dividends due to excess capital

Falling profitability ratios

Loan Yields will not rise dramatically

Banks deposit rates will rise

Spreads and margins will decline

Banks must find fee income

Banks must cut expenses

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Deposits

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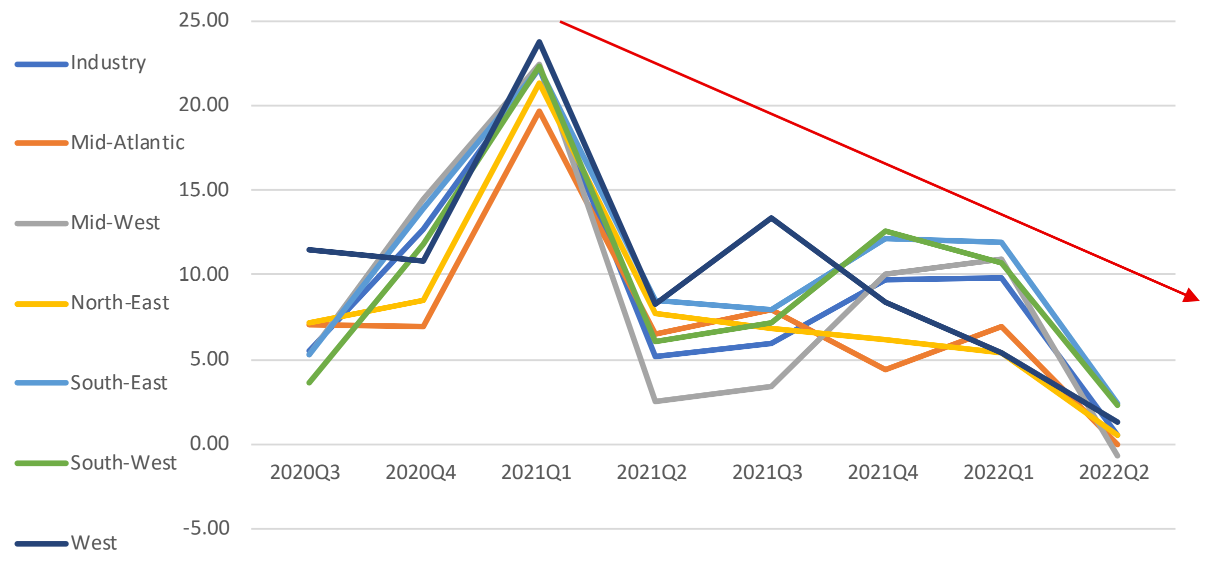
Industry deposit growth rates have slowed significantly and are expected to be flat to down in 2023 . . .

Deposit Growth Rate



Deposit Growth Rate	2020Q3	2020Q4	2021Q1	2021Q2	2021Q3	2021Q4	2022Q1	2022Q2	Change QoQ	Change YoY
Industry	**5.50**	**12.74**	**22.19**	**5.18**	**5.96**	**9.77**	**9.88**	**0.51**	**-9.37**	**-4.67**
Mid-Atlantic	7.05	6.95	19.63	6.53	7.90	4.45	6.96	0.00	-6.96	-6.53
Mid-West	5.26	14.49	22.46	2.54	3.42	10.03	10.92	-0.66	-11.58	-3.20
North-East	7.12	8.53	21.32	7.75	6.89	6.13	5.38	0.48	-4.90	-7.27
South-East	5.29	13.89	22.19	8.49	8.00	12.10	11.98	2.42	-9.56	-6.07
South-West	3.62	11.82	22.33	6.04	7.13	12.56	10.75	2.27	-8.49	-3.78
West	11.46	10.87	23.71	8.26	13.36	8.39	5.38	1.28	-4.11	-6.99

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Source: Call Report Data

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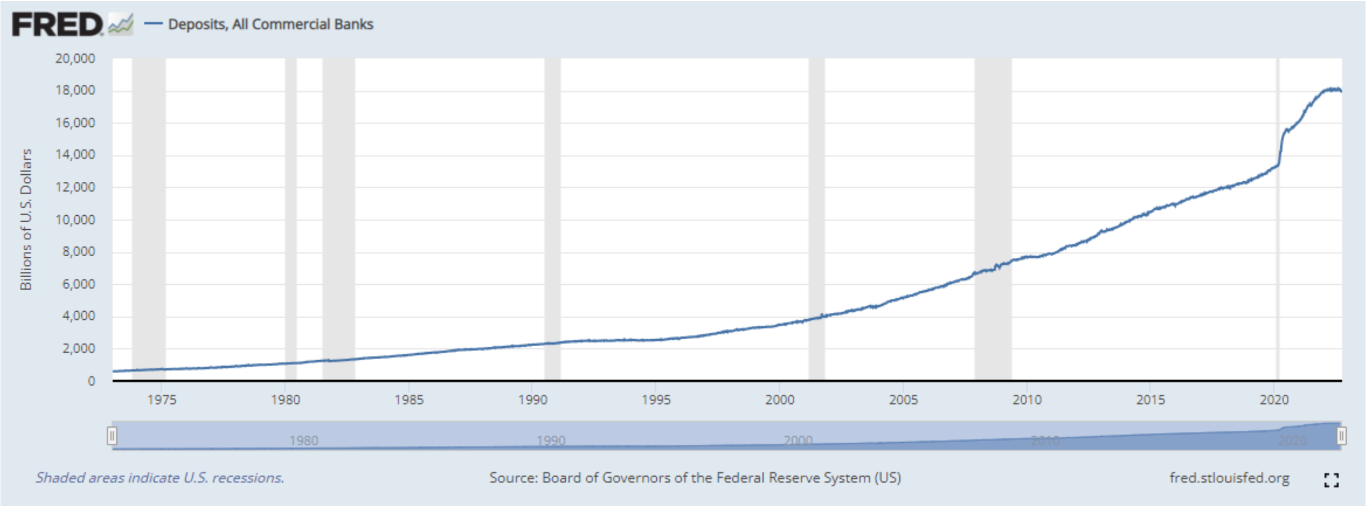
Total deposits will decline through the end of 2022 and into 2023, and Banks will be short funding . . .



Deposit inflows will stagnate and may even shrink.

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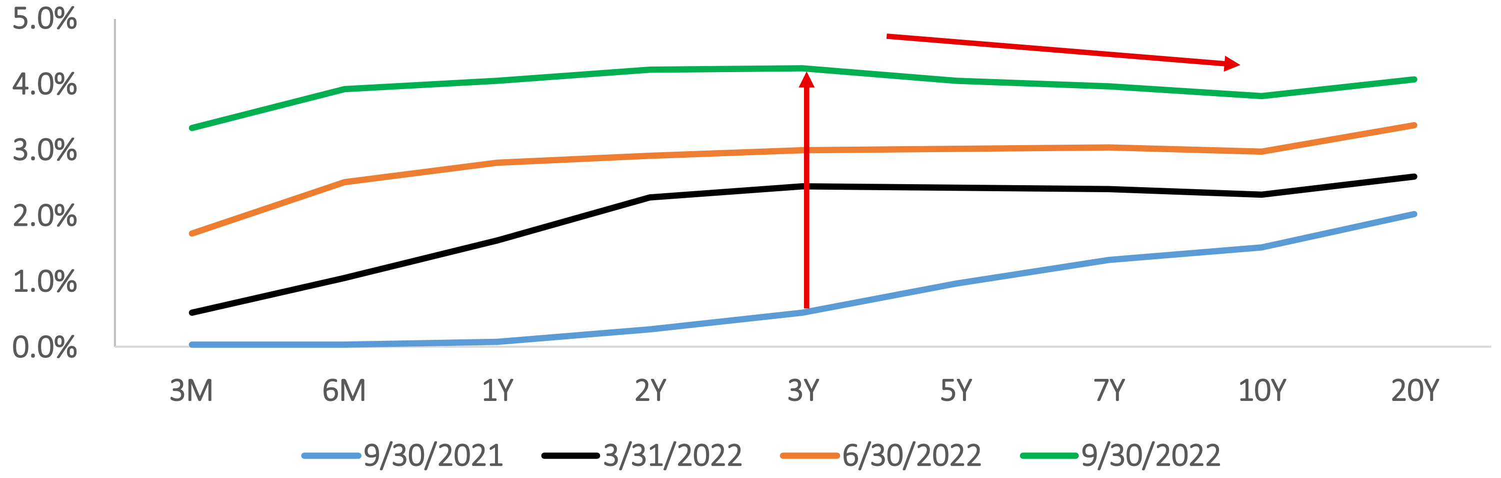
Data as of 10/7/22
Source: FRED, FinPro

The Treasury Yield Curve has shifted upward over the past year. In some instances, the curve has inverted . . .

Treasury Curve



	3M	6M	1Y	2Y	3Y	5Y	7Y	10Y	20Y
9/30/2021	0.04%	0.05%	0.09%	0.28%	0.53%	0.98%	1.32%	1.52%	2.02%
3/31/2022	0.52%	1.06%	1.63%	2.28%	2.45%	2.42%	2.40%	2.32%	2.59%
6/30/2022	1.72%	2.51%	2.80%	2.92%	2.99%	3.01%	3.04%	2.98%	3.38%
9/30/2022	3.33%	3.92%	4.05%	4.22%	4.25%	4.06%	3.97%	3.83%	4.08%

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Source: FactSet; FinPro

Loans

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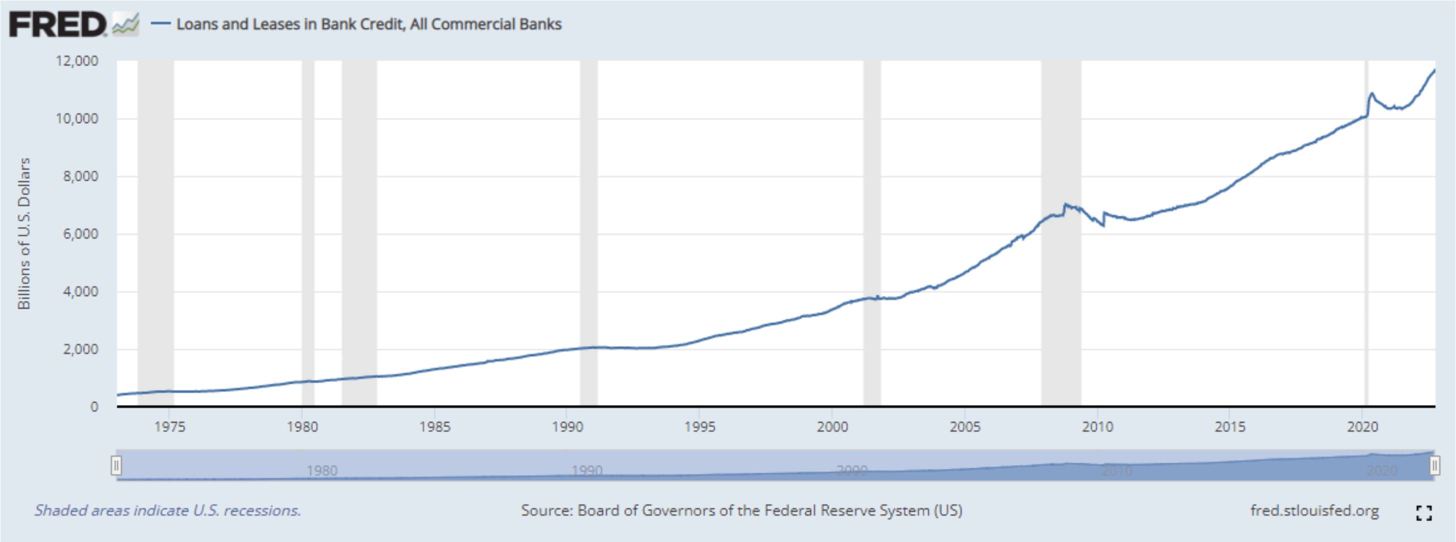
The future rate hikes by the Fed will impact loan demand significantly . . .



Loan demand will remain strong through 2022, but may decline in 2023

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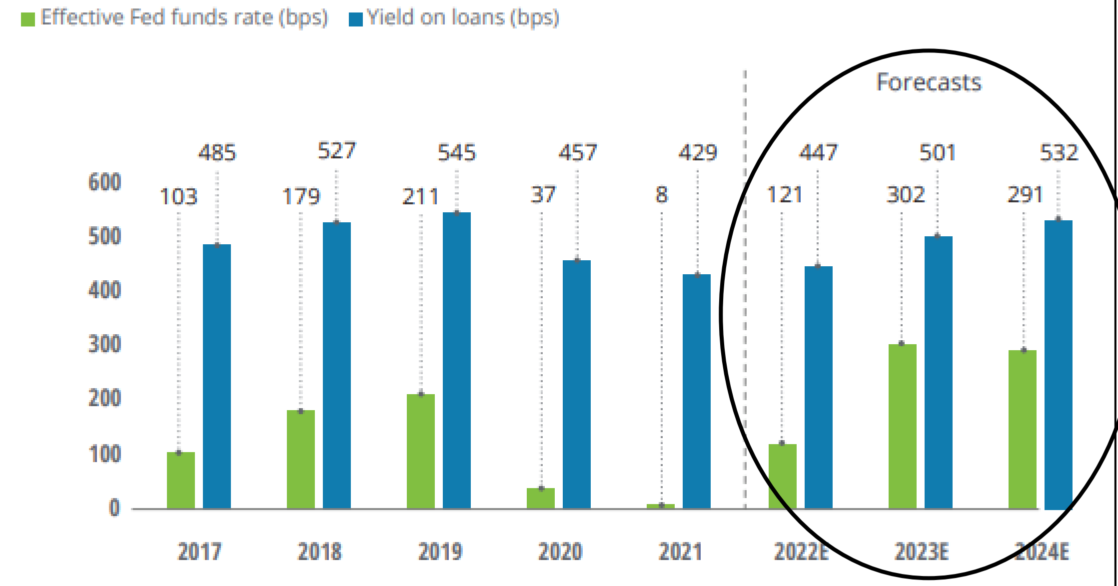
Data as of 10/07/22
Source: FRED, FinPro

Loan yields in the US will remain high into 2023 affecting the housing market and impacting affordability of home ownership . . .



Source: S&P Market Intelligence database.

Source: DI CFS FSI Outlook on Banking, October 2022

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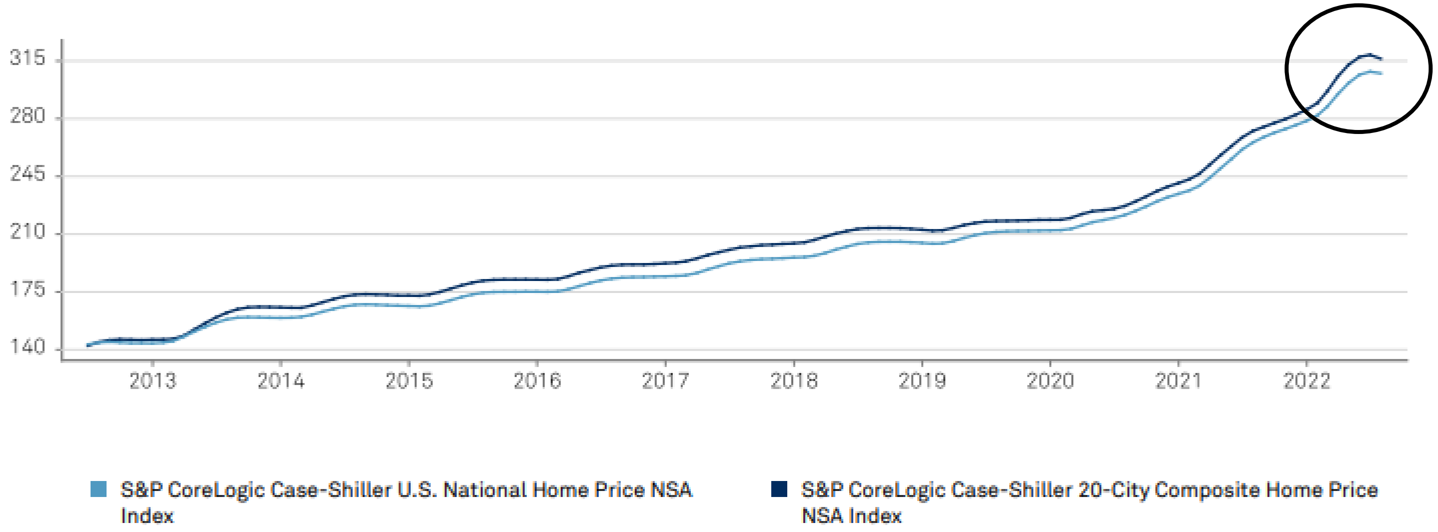
S&P CoreLogic Case-Shiller National Home Price Index which fell by 0.3% in July from June. This is the first month-over-month decline since January 2019. It is predicted that home prices could tumble another 7% by the end of 2023 . . .



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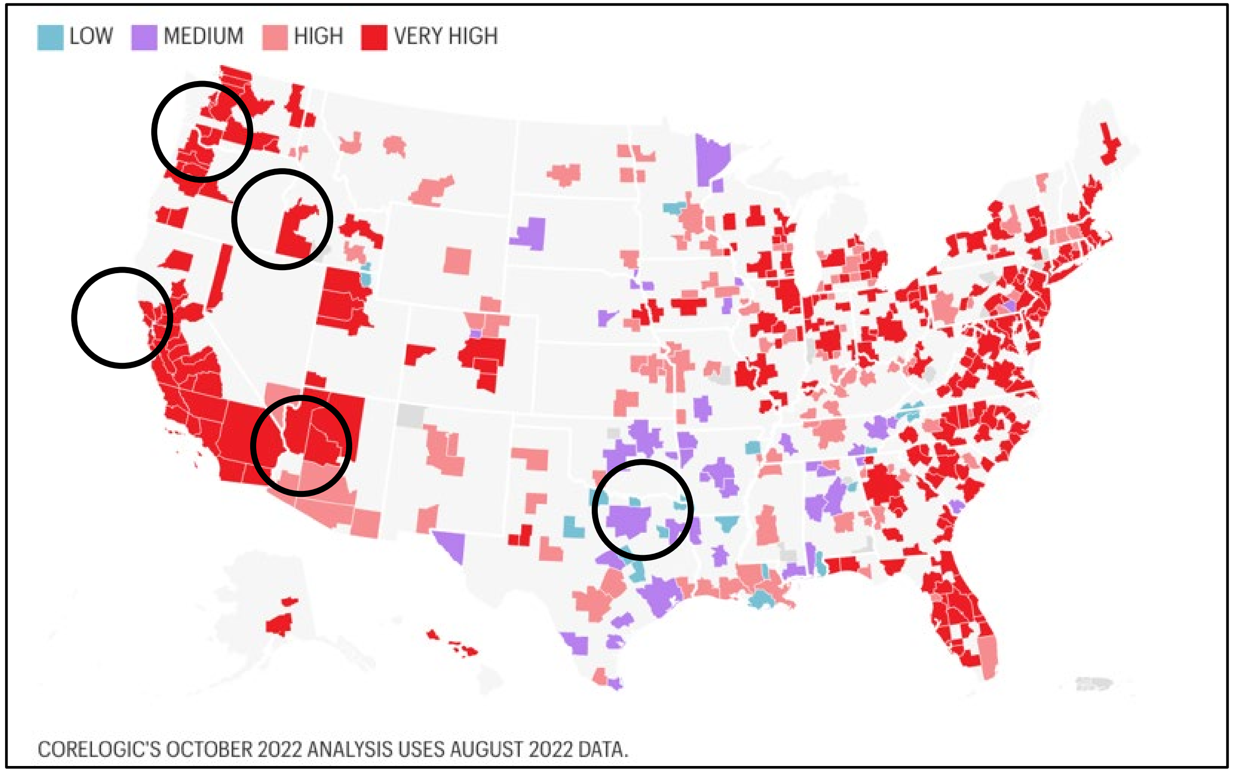
Source: S&P Global, Morgan Stanley, October 2022

There will be a U.S. housing correction driven by a spike upward in mortgage rates. High-cost tech hubs and bubbly markets will be hit the hardest . . .

- The first group are high-cost tech hubs (San Francisco down 7.8%, San Jose down 9%, and Seattle down 6.2% from its peak in 2022.
- Also, the “bubbly” markets such as: Austin (down 6.2%), Boise (down 5.3%), and Phoenix (down 4.4%).
- Austin and Phoenix are "overvalued" by 61% and 57%, respectively. “Overvalued" housing markets are the most vulnerable to home price cuts during a housing correction.



Data as of 10/7/22
Source: Moody’s Analytics, Forbes.com

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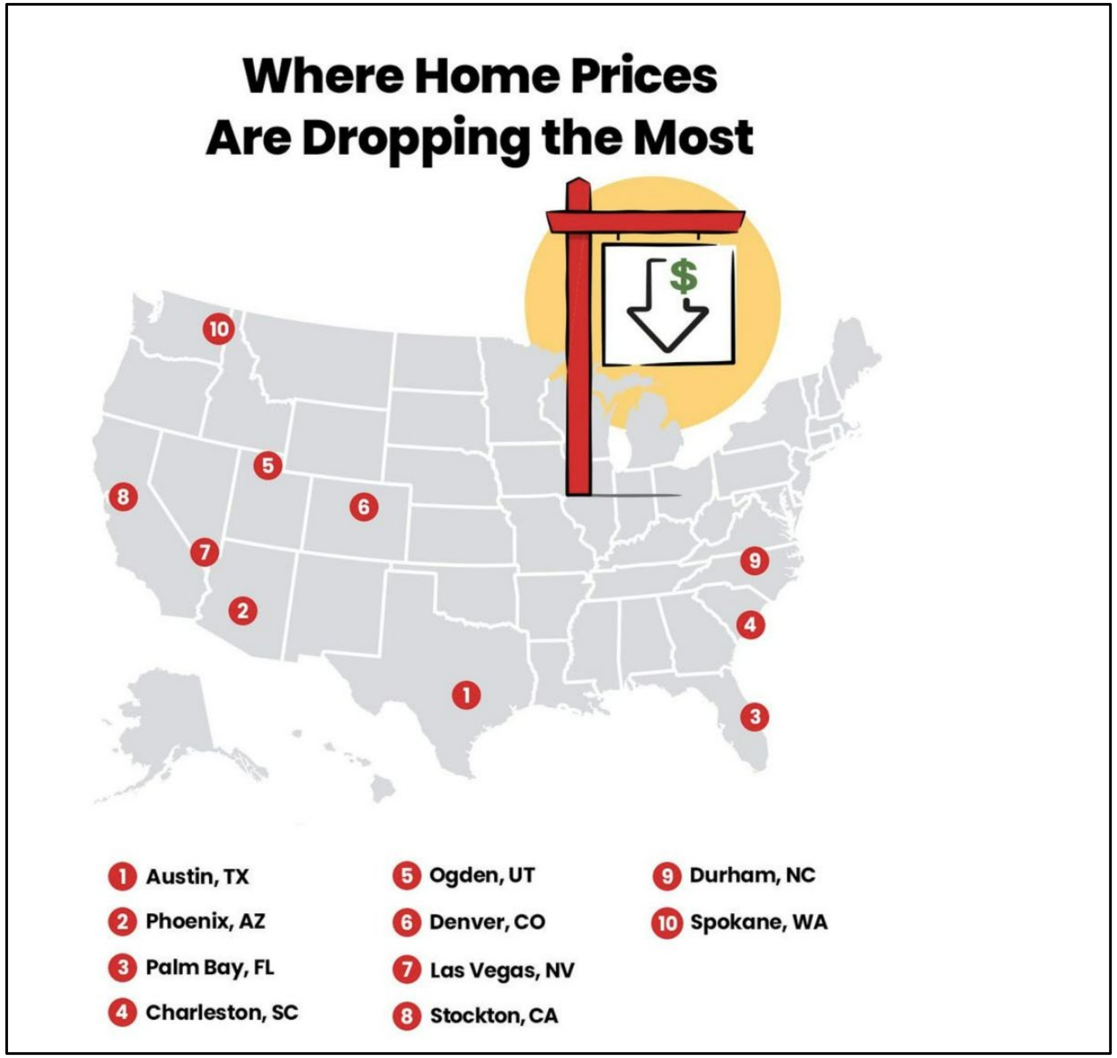
Similarly, Austin and Phoenix are top markets where home prices are dropping the most in value . . .



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Source: Realtor.com, Oct 12, 2022

Asset Quality

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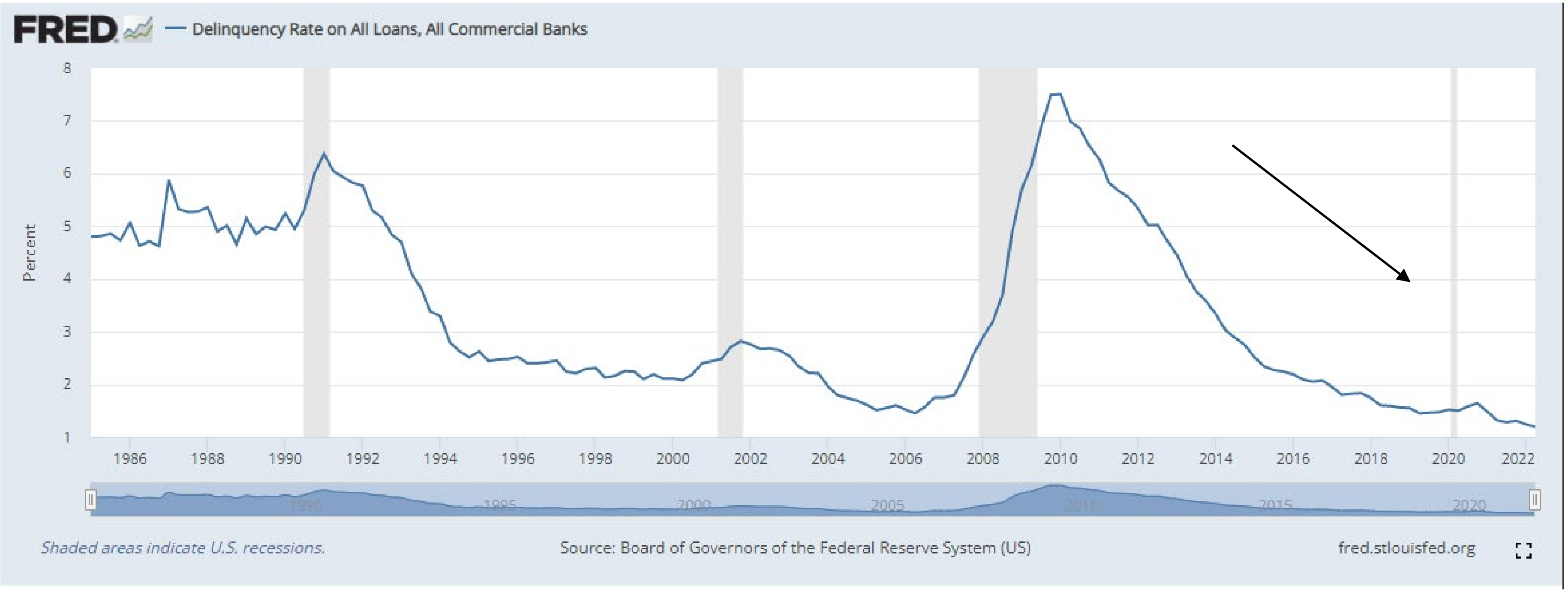
Total loan delinquencies are low as compared to historical levels . . .



The other good news is that delinquencies are, so far, under control, and evictions did not explode as projected with the lapse of the moratorium.

Data as of 8/31/22
Source: FRED, FinPro

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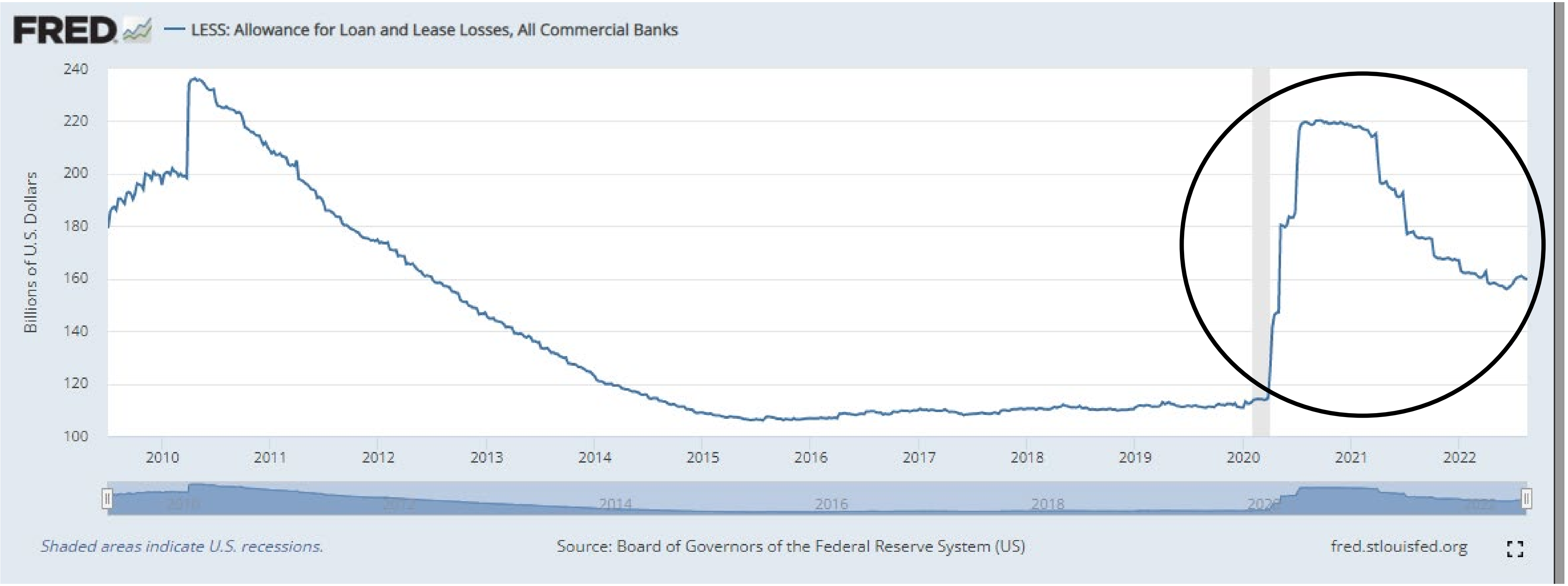
The volatility in the loan loss allowance is concerning . . .



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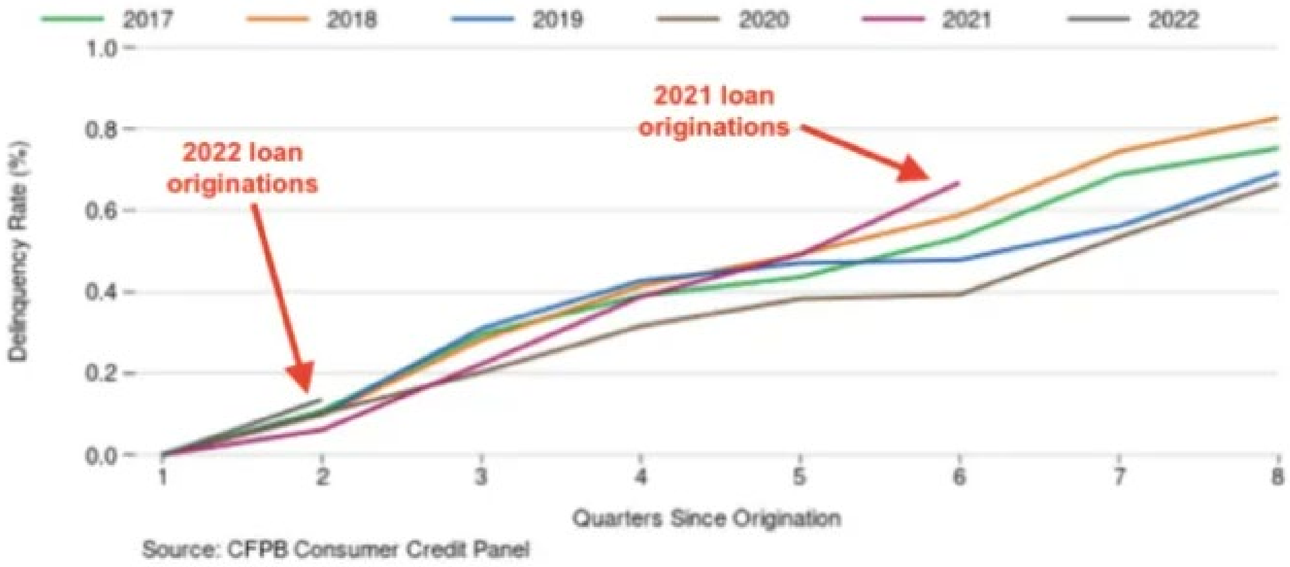
Data as of 8/31/22
Source: FRED, FinPro

Rising auto loan delinquencies is a troubling economic indicator that is putting more pressure on banks . . .



Auto loans originated in 2021 have a delinquency rate of 0.67 percent in the sixth quarter after origination, which is 13 percent higher than the delinquency rate of auto loans originated in 2018.

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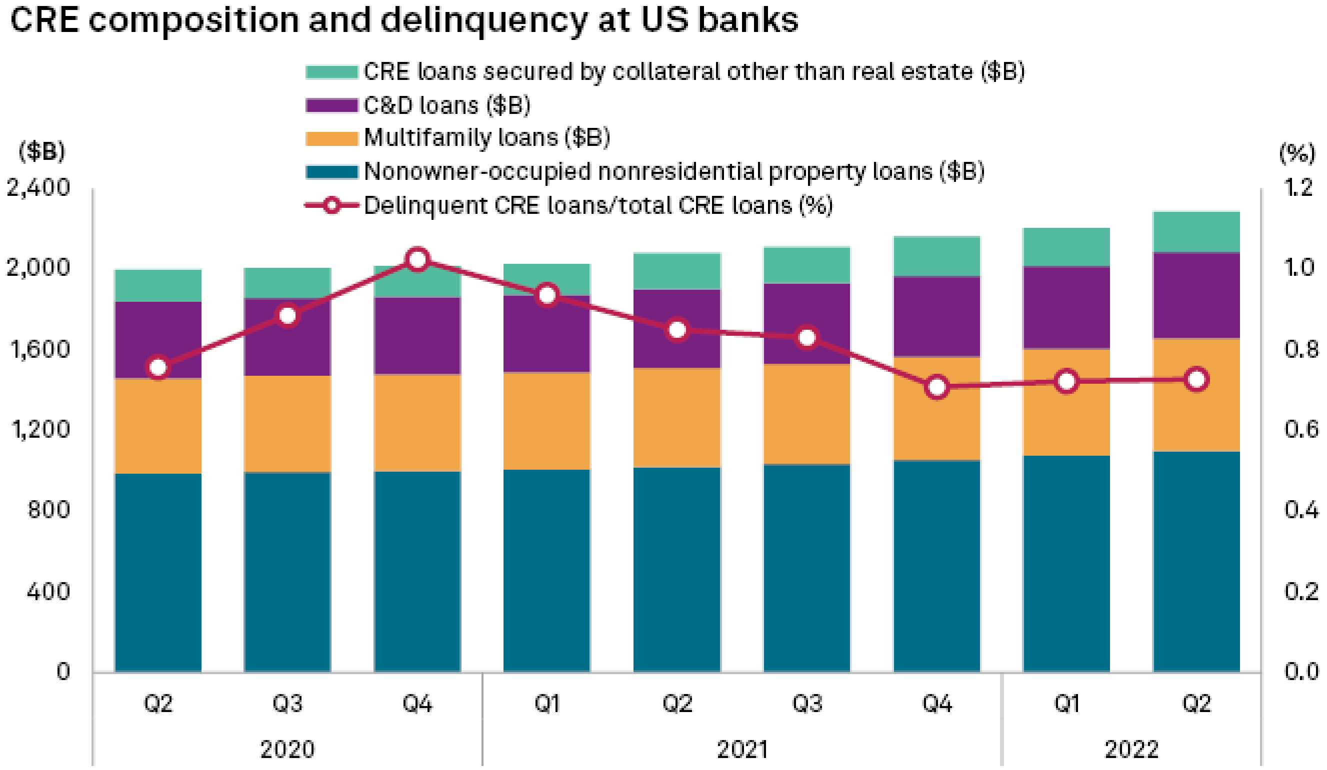
Data as of Source: CFPB Consumer Credit Panel Data as of August 30,2022

The delinquency rate on CRE loans has remained flat quarter over quarter at 0.73% . . .



Data compiled Aug. 30, 2022.
CRE = commercial real estate; C&D = construction and development
Delinquent loans consist of loans 30 or more days past due and loans in nonaccrual status.
Analysis based on aggregates for operating and historical U.S. commercial banks, savings banks, and savings and loan associations. Excludes nondepository trusts and companies with a foreign banking organization charter.
Data based on regulatory filings.
Source: S&P Global Market Intelligence

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Data as of Source: S&P Global Intelligence, Data as of August 30,2022

Fees

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- The FDIC has observed various risk-mitigating activities that financial institutions have taken to reduce the potential risk of consumer harm and avoid potential violations of law regarding multiple re-presentment NSF practices.
- Eliminating NSF fees by:
  - Declining to charge more than one NSF fee for the same transaction.
  - Conducting a comprehensive review of policies, practices, and monitoring activities related to re-presentments.
  - Making appropriate changes and clarifications, including providing revised disclosures to all existing and new customers.
  - Clearly and conspicuously disclosing the amount of NSF fees to customers and when and how such fees will be imposed, including:
    - Information on whether multiple fees may be assessed in connection with a single transaction when a merchant submits the same transaction multiple times for payment
    - The frequency with which such fees can be assessed; and the maximum number of fees that can be assessed in connection with a single transaction.

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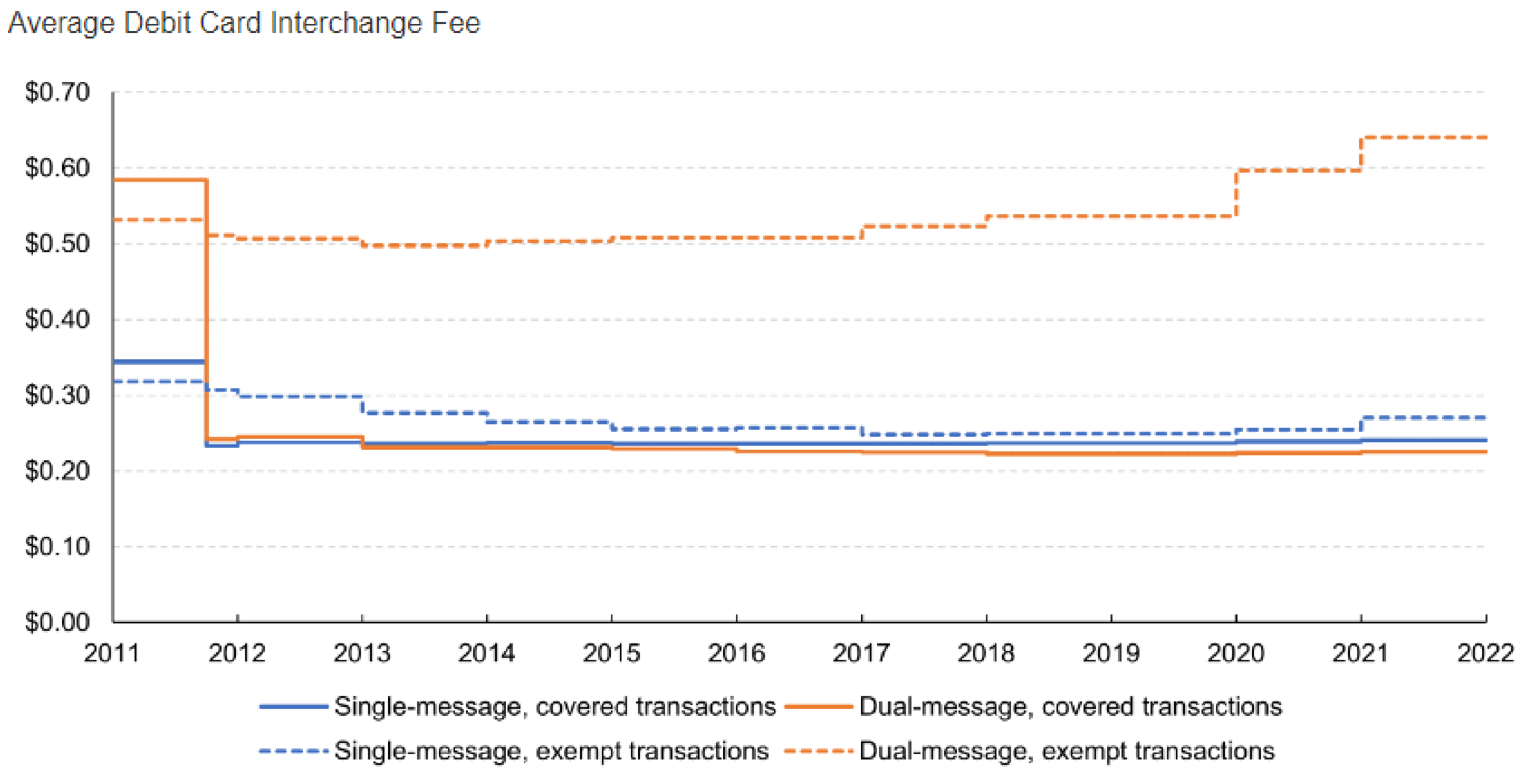
Data as of Source: FDIC Issues Guidance on Representment Fees, September 21, 2022

- Congress is taking aim at interchange fees, which merchants must pay anytime a customer swipes their card.
- Interchange fees are paid to the bank that issued the card to cover associated risks and costs.
  - Regulation II states a covered issuer may not receive for an electronic debit transaction, an interchange fee that **exceeds** $0.21 plus 0.05 percent multiplied by the value of the transaction, plus a $0.01 fraud-prevention adjustment.



Data as of Source: Federal Reserve, Regulation II, 2022

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Expenses

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1. Proper planning and research – find the best outsourcing company
2. Cost cutting strategies – streamline processes, utilizing automation tools, tightening procedures
3. Then cost cutting strategies should be prioritized
4. Cost saving statistics – businesses experience more profitability using outsourcing solutions

1. **27%** of organizations outsource to reduce costs.
2. **78%** of businesses have healthy and profitable partnerships with offshoring and outsourcing companies.
3. **70%** of companies consider cost-reduction as the driving factor for seeking outsourcing solutions.
4. **24%** of small businesses utilize outsourcing solutions to improve efficiency despite limited funding.
5. **66%** of organizations with 50 or more employees outsource.

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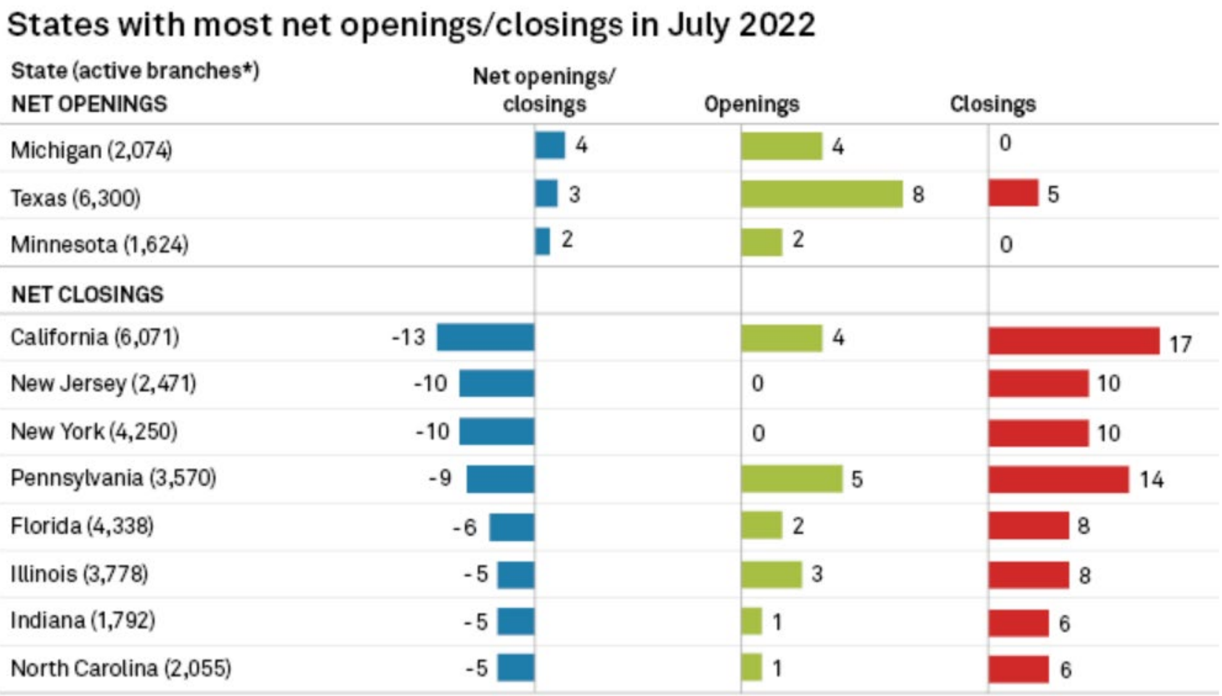
Banks are seeking cost savings by closing brick and mortar branches. There were more closing bank branches than openings in July 2022 . . .

- The top 3 states are: California, New Jersey, and New York with the highest net opening/closings.



Data compiled Aug. 23, 2022.
Ranking based on U.S. bank and thrift branch net openings/closings for July 2022.
Limited to states with two or more net openings, or five or more net closings.
Branch openings and closings are limited to cases where opening and closing dates are available.
Branch data collected on a best-efforts basis.
Excludes foreign banking organization branches and credit unions.
* Active branch data based on the FDIC's June 30, 2021, Summary of Deposits filings and pro forma adjusted for branch openings or closings as of July 31, 2022.
Source: S&P Global Market Intelligence

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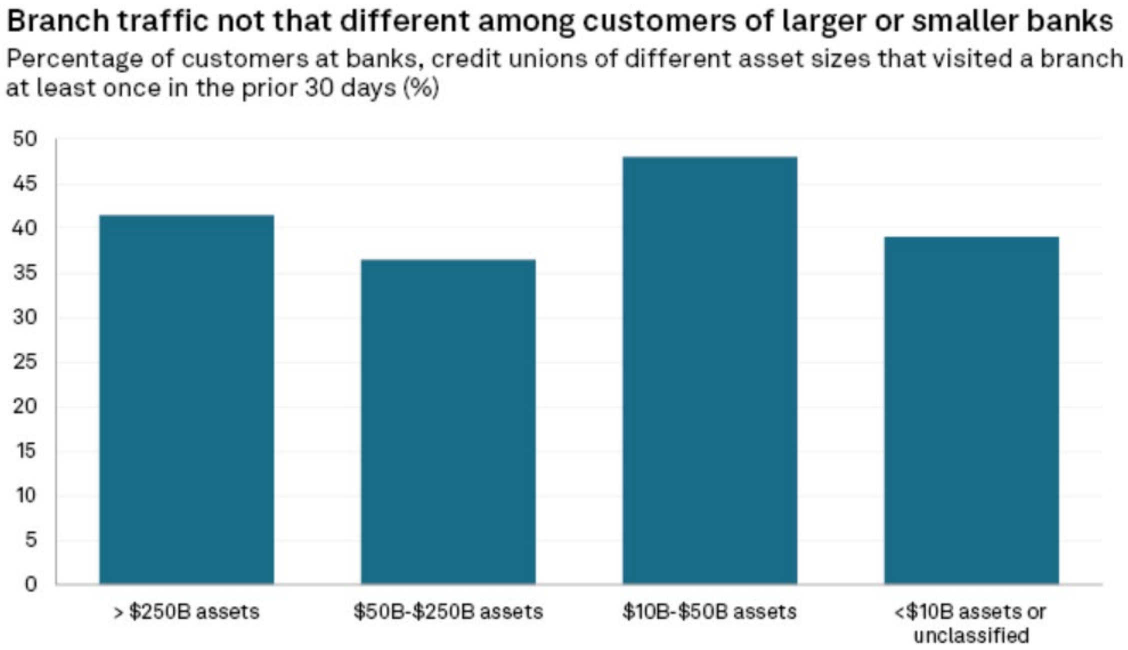
Data as of 8/23/2022
Source: S&P Global Intelligence

Branch traffic is not that different among customers of larger or smaller sized banks. Branch traffic is less than 50% while digital traffic is more than 50% on average . . .



Data compiled Aug. 16, 2022.
Asset groups designated by the response to the following question: At which bank or credit union is your primary checking account?
Based on responses to the following question: How many times in the last 30 days did you visit a branch of your primary bank or credit union (e.g. to visit an ATM, talk to teller, use the drive-thru)? (Select only one)
>$250B N = 2,210. $50B-$250B N=573. $10B-$50B N=248. <$10B or unclassified N=969.
Sources: S&P Global Market Intelligence 2022 U.S. Mobile Banking Survey, an online survey of 4,000 U.S. mobile bank app users conducted April 2022-May 2022.

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Data as of 8/25/2022
Source: S&P Global Intelligence

Income

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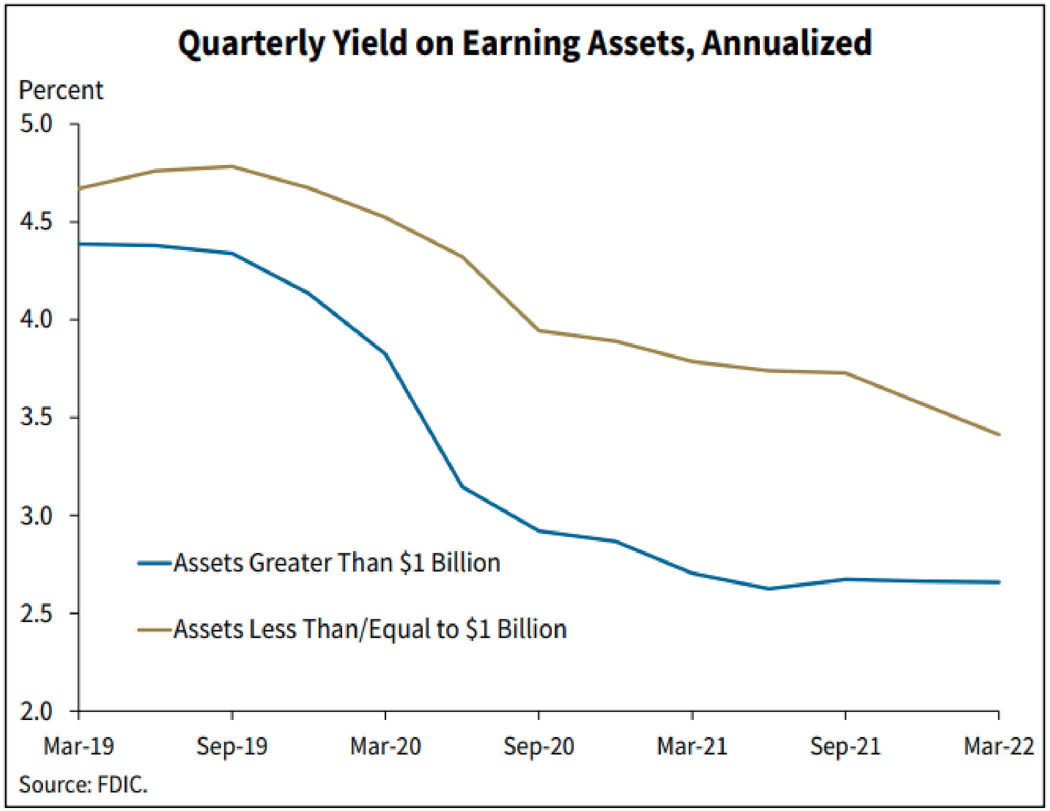
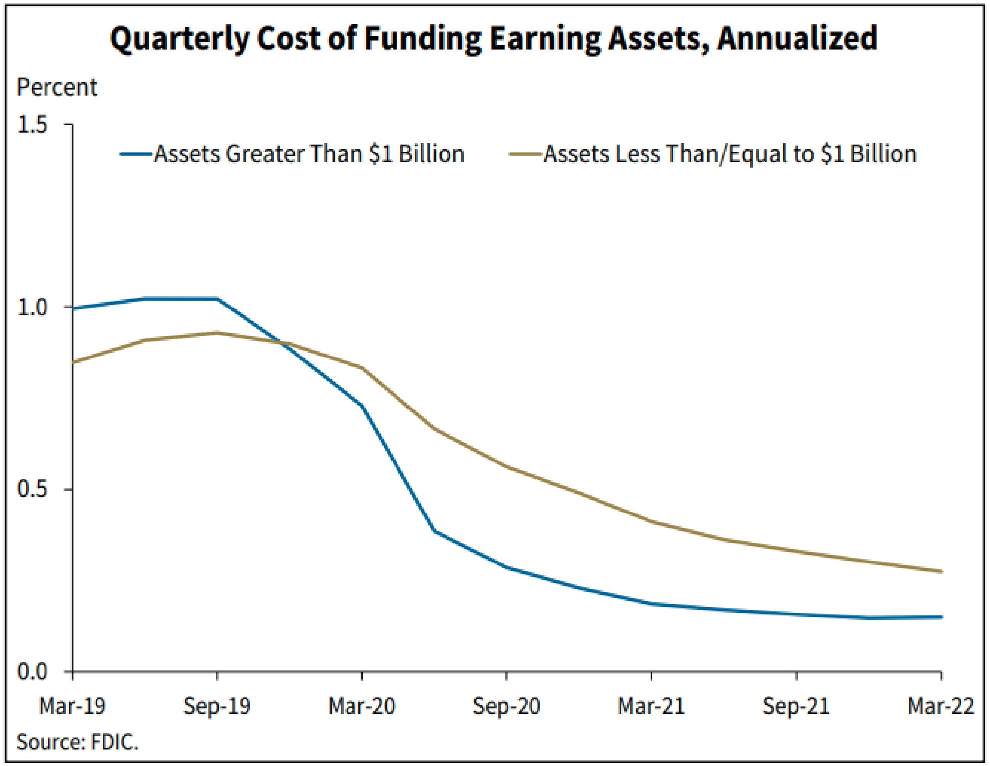
Earning asset yields are declining and cost of funds have bottomed out . . .





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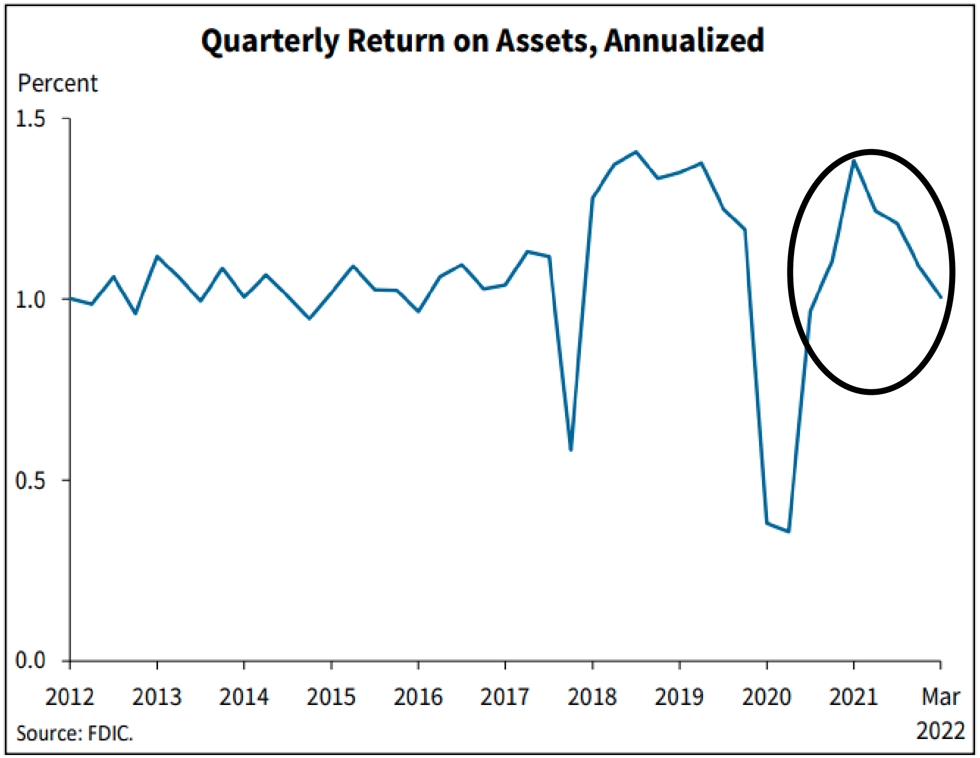
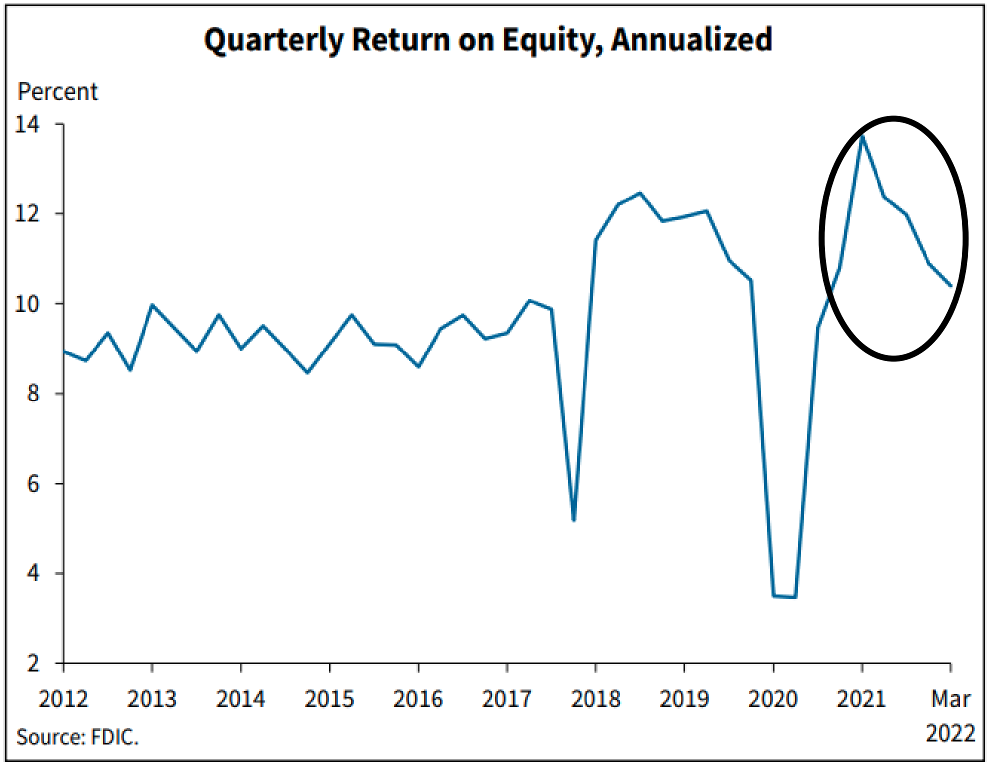
Data as of 3/31/2022
Source: FDIC, FinPro

And overall profitability has peaked . . .





We are now losing the PPP benefit and experiencing margin compression concurrently.

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Data as of 3/31/2022
Source: FDIC Graph Book, FinPro

Demographic Environment

Wealth shift

Rise of millennials

More immigration

Women in power

Changing social norms

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Top Seven Demographic Trends for 2020 and Beyond

1. Millennials: A Force to Reckon With
2. Changing Home Life
3. Women in the Labor Force
4. Immigrants Drive Population Growth
5. Migration to the South and the West
6. More Boomers are Set to Retire
7. The Changing Landscape of Cities and Suburbs

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We will go through a record generational wealth shift . . .

Baby Boomers
(Born between 1946 and 1964)

$30 to $60 Trillion

Millennials
(Born between 1981 and 2000)

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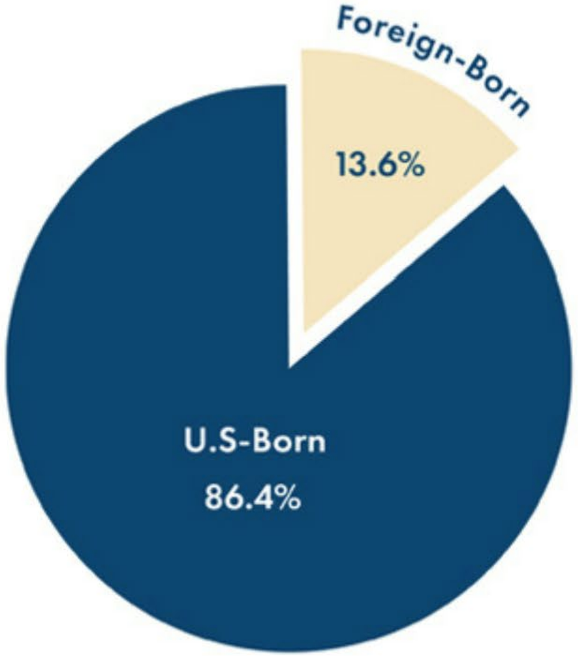
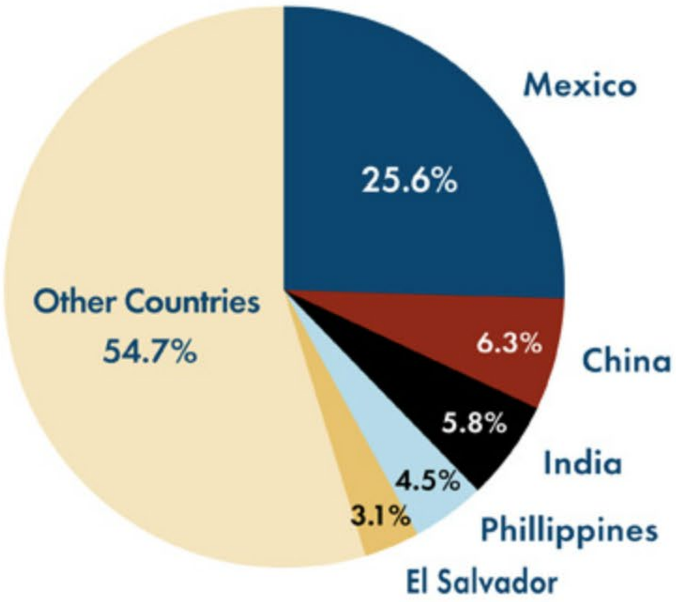
There are approximately **44 million immigrants** in the United States.

About one in every eight U.S. residents (13.6%) is foreign-born.



The five largest immigrant populations in the United States are from:



Source: U.S. Census 2019 American Community Survey 5-year Estimates

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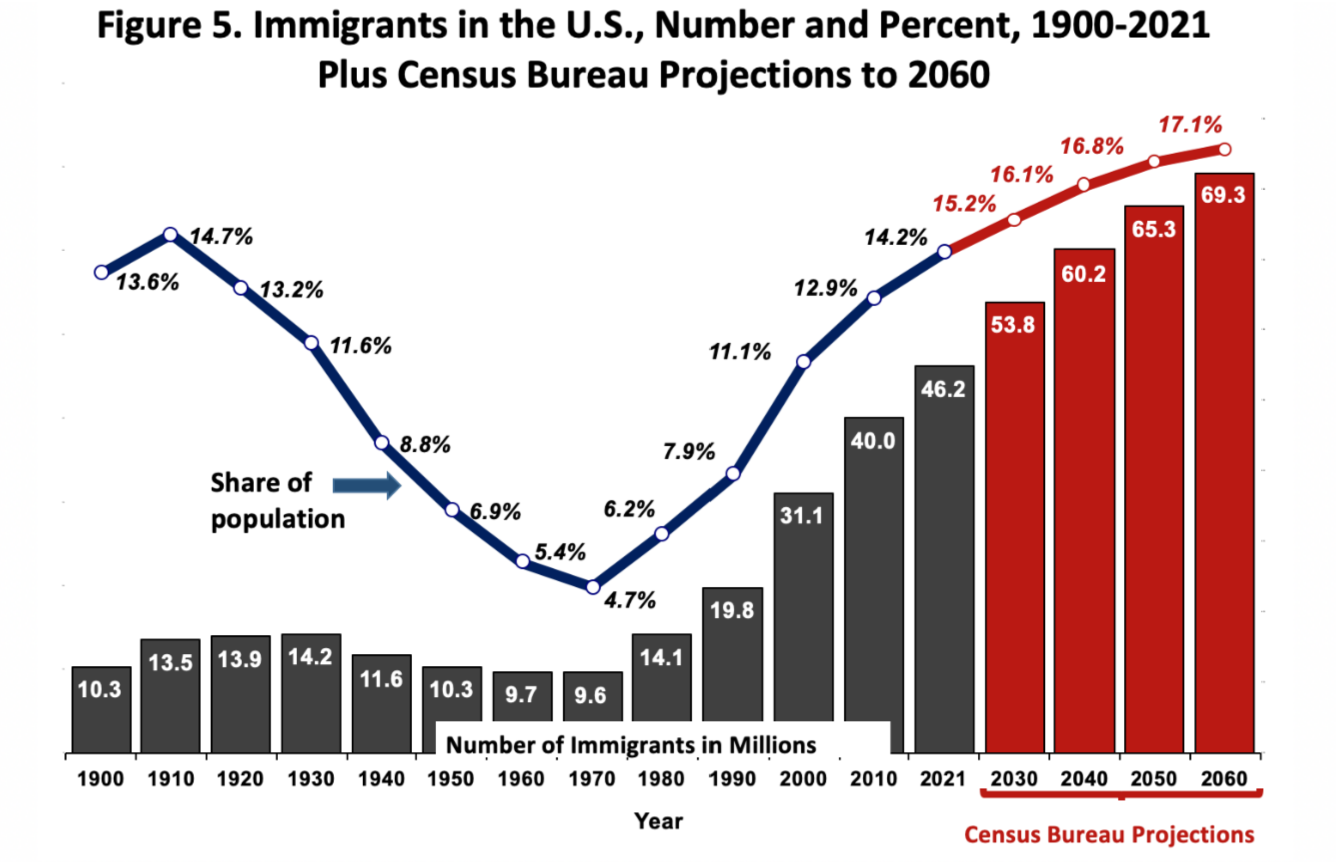
And the future projections are darn scary . . .



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Demographic actions for consideration . . .

1. How can Banks attract Millennials and Gen Z?
2. How do we deliver products and services differently to match the new cultural expectations?
3. How do we prepare for Wealth Transfer?
4. We need to consider bundling specific products for specific segments.

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Effective Corporate Governance

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The evolution of Bank Boards is occurring at an accelerating pace . . .

1. Presumptive Knowledge, Credible Challenge and Documentation Reality
2. Fiduciary duty –To whom?
3. Training
4. Expertise
5. Board Diversity (SEC, CA, NY, ISS)
6. Board Expectations
7. Recent Issues to be Aware of
8. Better Board Meetings

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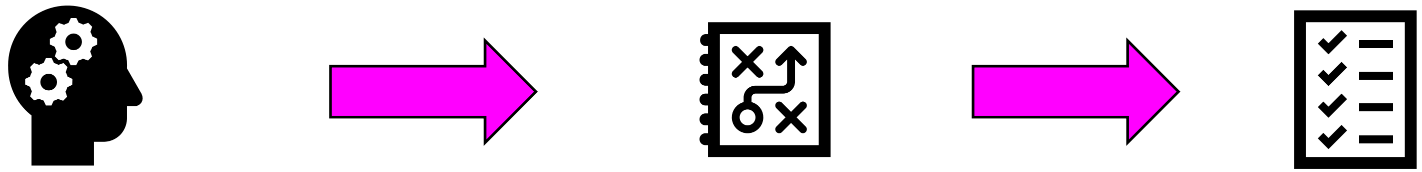
1. To protect yourself and your Board, understand the “Big 3” . . .

- Presumptive knowledge
- Credible challenge
- Documentation Reality



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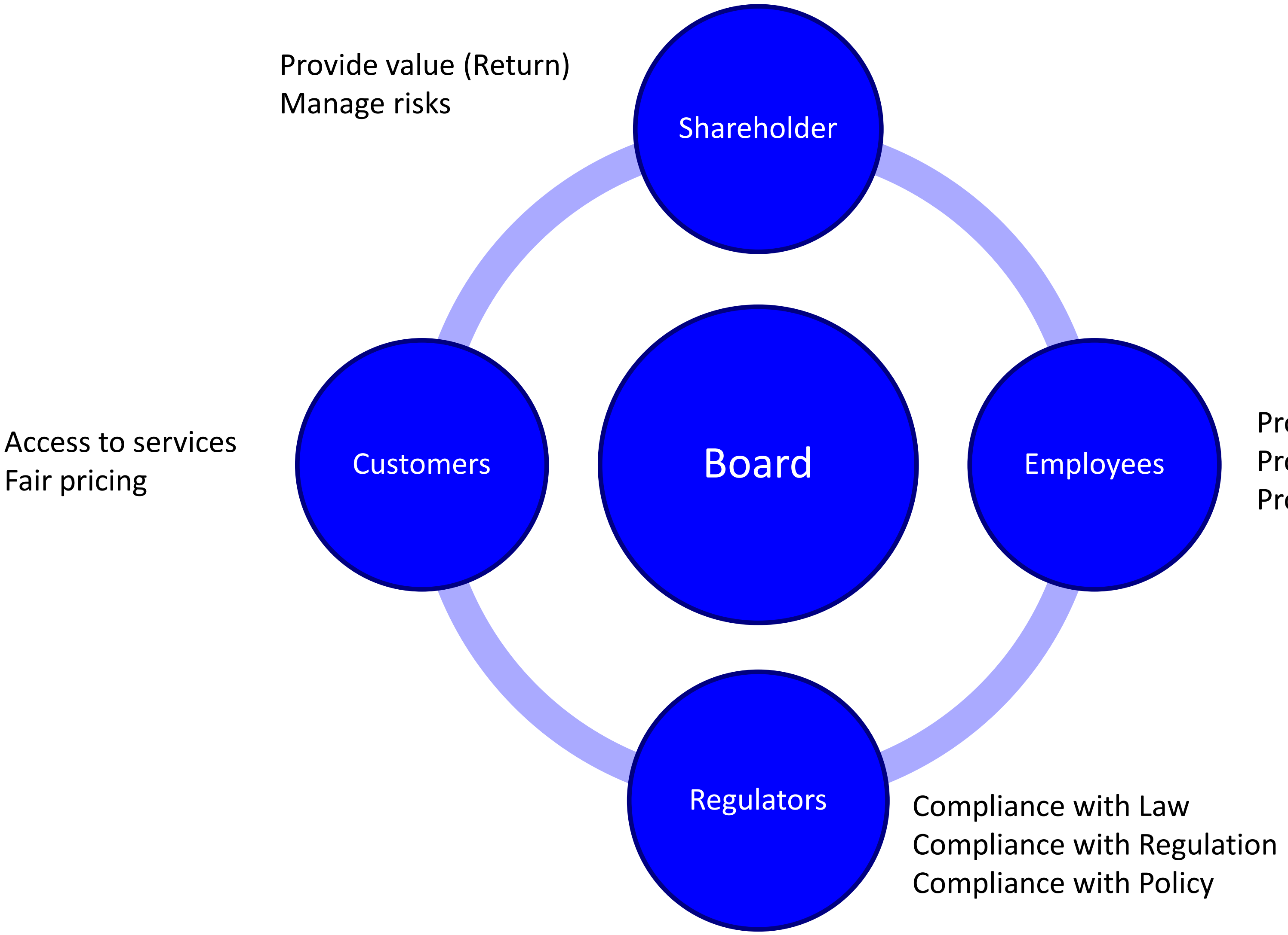
2. Directors have numerous constituents. Properly prioritizing and aligning these responsibilities and risks is a key role of a director . . .



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- Select and retain competent management, talent development and succession planning
- Supervise management
- Understand the bank's risk profile
- Set risk objectives and parameters
- Establish, with management, long and short-term business objectives
- Strategic planning
- Maintain independence
- Adopt operating policies
- Monitor operations and oversee business performance
- Provide for independent reviews
- Heed supervisory reports
- Keep informed, and
- Ensure meeting community's credit needs

Talent Management
ERM
Strategic Planning
Corporate Governance

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4. Regulators are looking for specific expertise on Boards. Typical Board expertise of a $5 billion to $10 billion dollar bank . . .

- Chair
- CEO
- Qualified Financial Expert
- Technology Expert
- Risk, Regulatory Expert
- Business Topic Expert
- Family/Large Investor
- Banking Expert
- ESG Member
- 2 - At Large

Board Diversity (Gender, Ethnicity, etc.)
Should include representation for various markets

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Board composition is important . . .

- Keep Board size manageable (typically 7 to 11)
- Quorum should be at least 50% independent directors
- Minimally, have an Independent Lead Director
- Directors should be nominated based upon their independence, diversity, skills, qualifications and unique insight
- Obtain a diversified set of skills and expertise on the Board
  - financial expert, technology expert, regulatory expert, banking expert, topical experts, business model experts
- New wave is seeking Diversity (Women and Minority)
  - California Law Requiring Women on Public Companies
  - Carolyn Maloney Proposal
  - Elizabeth Warren Proposal
- Know environmental, social and governance issues
- Director composition should reflect the markets that the Bank serves and should generally either live or work in relative geographic proximity to the institution
- Boards of Directors should represent:
  - Large investors
  - Management (limited to less than 1/3rd):
  - Family members

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5. Diversity is a key topic today . . .

- Gender
- Race
- Age
- Markets
- Areas of Expertise

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Where do you find new candidates? Think outside the box . . .

- Use your current group of friends…but rather than asking them to join the board, explain your desire to diversify and see if they can recommend appropriate candidates.
- Advisory Board Members
- Local business organizations
- Local college professors
- Check with your lending officers for leads

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6. Board Responsibilities keep increasing . . .

- Selecting and retaining competent management
- Establishing board structure appropriate to the bank's size and activities
- Delineating a strategic plan and establishing objectives
- Identifying and understanding the risks presented by objectives and strategies and developing an appropriate risk management structure and framework
- Establish risk appetite
- Establishing policies and procedures to attain objectives
- Monitoring and assessing the progress of operations and business performance
- Ensuring that the bank is in compliance with laws and regulations
- Ensuring the bank is meeting the needs of the local community
- Ensuring ethical decision making and operations
- Thinking independently of management and evaluating proposals from management and others carefully
- Identifying potential strategic opportunities for the institution
- Maintaining confidentiality and limiting disclosure
- Exercising their individual judgment – not all board votes should be unanimous
- Provide credible challenge to management
- Taking steps to identify, measure, monitor and control risks
- Serving as a spokesperson in representing the Company and its positions
- Evaluating the Board's performance
- Setting expectations and communicating them completely
- Promoting open and honest discussion
- Attending all meetings well prepared for discussion
- Disclosing any potential conflicts of interest

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Corporate Governance issues will continue to have significant impact on Bank directors, and expectations for Board members are high . . .

- Board members should attend a minimum of 75% of all meetings, in person
- Board members are expected to know and understand laws and regulations
- Board members are expected to know and understand the institution's financials
- Internal and external auditors should report directly to the board and there should be some one-on-one time with the Board and auditors
- Board members are expected to participate in education and training going forward, leveraging both internal and external resources
- Consideration should be given to Board succession, as appropriate Board expertise can be difficult to find and attract
- Build the Board to bring business to the bank or add value to the Bank
- The level of insider income and benefits should be carefully reviewed
- Director composition should reflect the markets that the Bank serves

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7. Recent Issues . . .

- Not "correcting all issues identified in the ROE"
- Not being "fully informed"
- Not understanding the "high level risks" to the Bank
- Not effectively "supervising" management
- Self enrichment
- Not disclosing "all insider transactions"
- Not managing concentrations
- Not having "any diversity"

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- FDIC Lawsuits over Corporate Governance generally fall into the following categories
- Dishonest conduct or abusive insider transactions
- Failure of bank to adhere to law, internal policies or supervisory agreement
- Failure to establish proper underwriting policies or to adhere to such policies

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Board Meetings

Agenda → System → Package → Process → Minutes

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Always have an agenda . . .

- Utilize Consent Agendas
- Follow consistent format
- Should allow for Board input
- Line items need to be classified as Consent, Action, Discussion and Information to tell Directors the priority and expectation for that agenda item
- The individual responsible for presenting should be clear
- Provision for discussion and notes is essential
- Needs to be flexible

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Have an automated Meetings Management System . . .

- Full calendar management
- Click through Agendas
- Utilize any kind of document
- Remote voting
- Capture action items
- Access from anywhere
- Access from any device
- Security, security, security
- Document Control
  - Reduce proliferation of documents
  - Fix version control and conflicting data
  - Manage access
  - Assign employee ownership
  - Know when critical documents are expiring

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The Board package must be complete . . .

- Receive Board package in advance of meetings
  - Directors should read, interpret and analyze issues prior to meeting
  - Insist that proposals that do not make sense be clarified, modified, or rejected
  - Proposals should discuss pro's and con's of an issue and should justify the recommended course of action
  - Prepared Board members provide better insight and discussion
- The actual documents need to be attached to the agenda item
  - Critically important to have resolutions pre-populated
- Outside presenters need to be identified and qualified as experts
- Data provided must be timely and accurate
  - Regulatory ratios
  - Financial data
  - Responses to regulatory examinations
  - Value creation and factors that influence Bank value

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Board process matters . . .

- Allow time for, and promote discussion
- Follow Roberts Rules
- Capture voting data
- Assign Employee Responsibility and Accountability for Action Items
  - Capture action items generated during a meeting
- Involve management expertise in areas where relevant
- Don’t take votes on issues that have not been fully analyzed and presented thoroughly
- Always ask if Executive Sessions are required, hold at least quarterly regardless

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Suggestions for Minutes . . .

- The minutes should reflect discussion on topics and differing points of view (i.e. Credible Challenge)
- Consistent and Complete Meeting Minutes
  - Minutes should reflect what actually happened
  - Minutes need to be finalized in a timely manner and approved within two weeks of the meeting
  - Permissioned access to agendas and minutes
  - Do not let various copies of meeting minutes float around in multiple email chains
- Should be available next day while its fresh in Board members minds

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To avoid Governance problems, conduct a Corporate Governance Review . . .

- Examine the management reporting structure and organizational chart
- Review management position descriptions
- Review insurance adequacy
- Assess the current structure and composition of the Board and its committees
- Review Board Agenda's to improve efficiency
- Assess the Board's process management governance system
- Assess the Board's meetings management governance system
  - Audit
  - Compensation
  - Risk
  - Loan
- Assess the organization's vendor management governance system
- Assess the organization's talent management governance system
- Assess the organization's leadership and education management governance system
- Assess the independence of the Audit Committee (if applicable) and its follow-up procedures
- Provide recommendations for the overall improvement of corporate governance at the organization

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ESG Environment

Forced quotas

Form over substance

Forced climate ideology

Stronger governance rules

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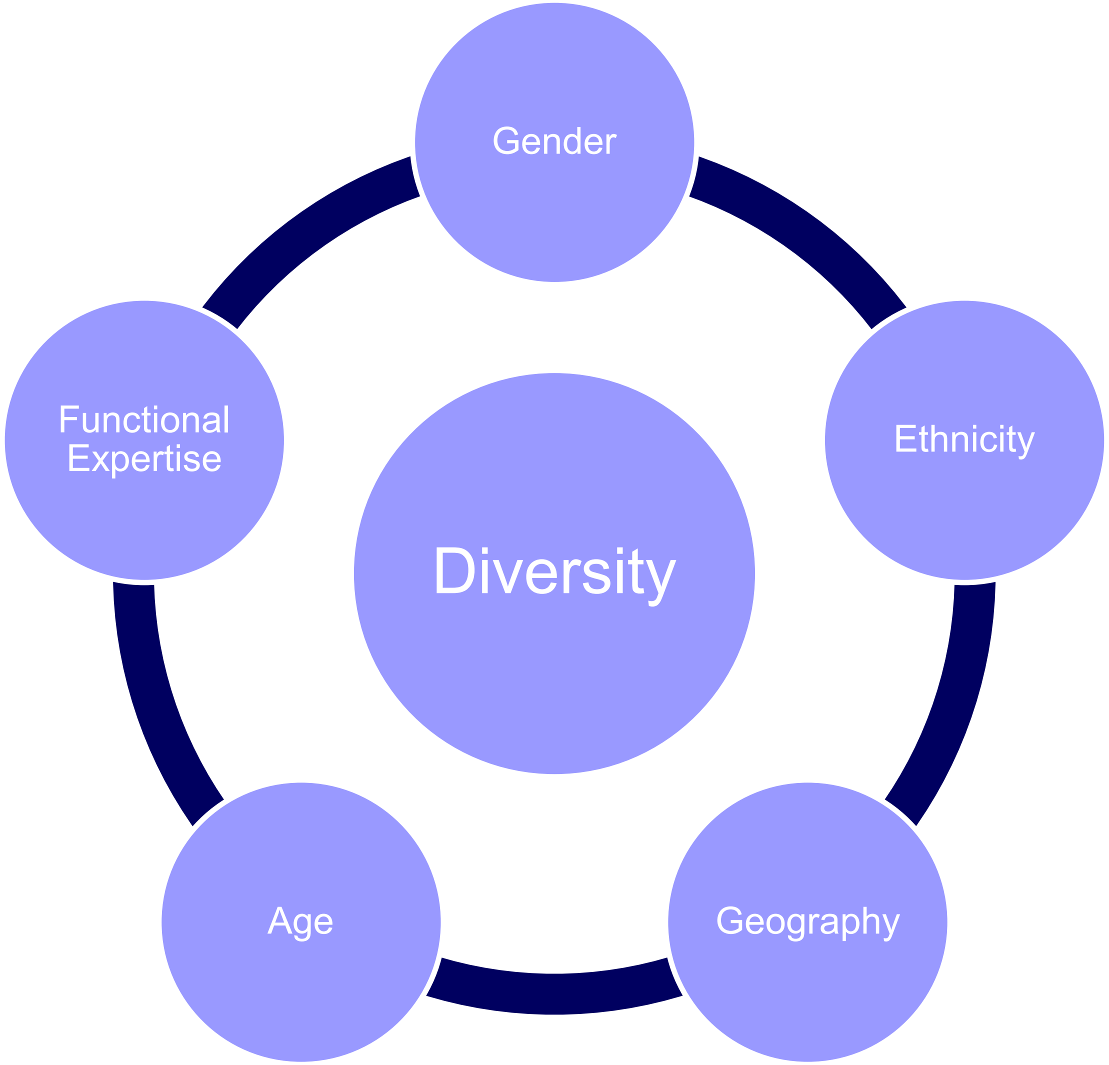
From a social standpoint, the buzz is for broader diversity . . .



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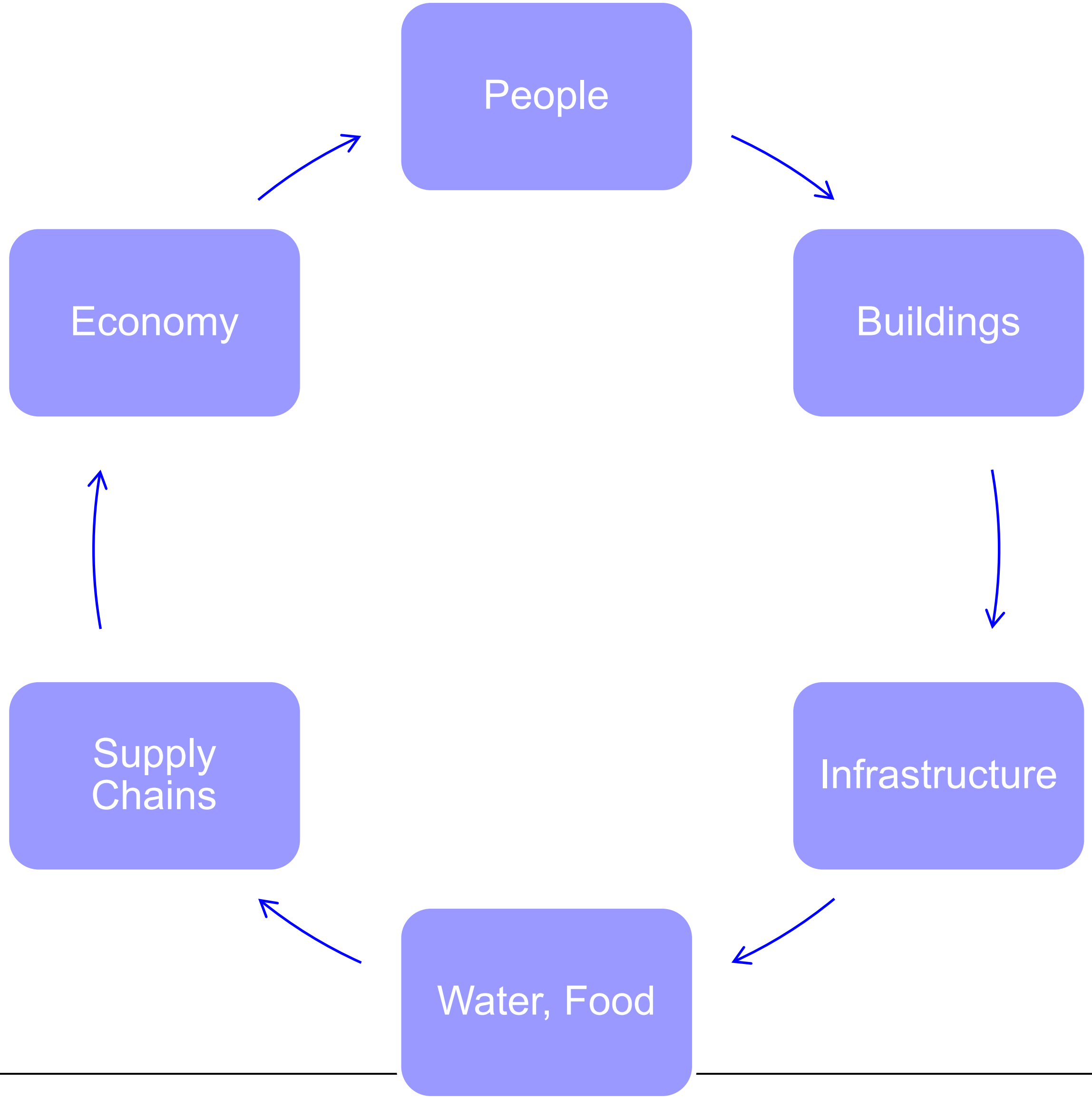
When it comes to Environment, Climate Risk has taken center stage . . .



Will “Operation Chokepoint return? The attack is primarily on fossil fuels and 2nd Amendment Companies

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ESG actions for consideration . . .

1. Get prepared for Climate Change but do not pre-emptively issue a Policy
2. Compile a list of all the environmental improvements you have made or plan to make
3. Enhance diversity and be prepared to answer questions on it
4. Compile Board Value Matrix
5. Understand what your large customers are doing to solve for ESG related issues

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Regulatory Hot Topics

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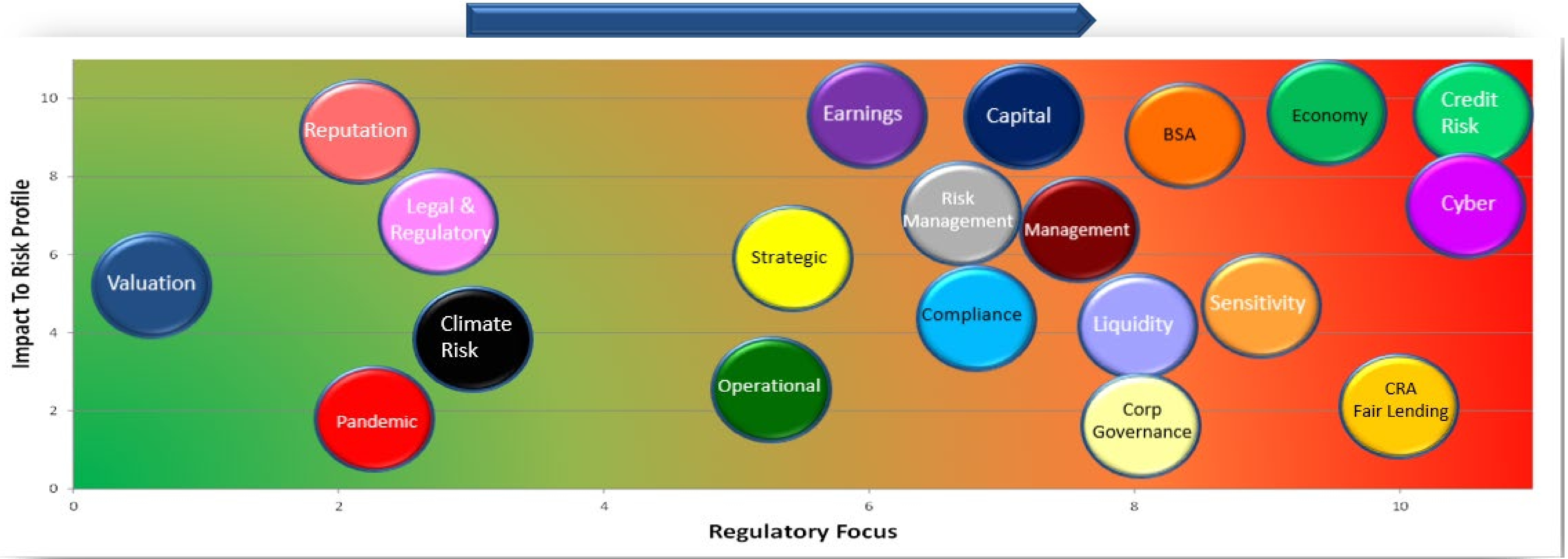
CAMELS+ Component Trend: Inflation, Rising Interest Rates, the Risk of a Future Recession, and Cybersecurity are the greatest risks to the financial services sector . . .

2022 and beyond



The chart above illustrates the CAMELS+ components and the overall regulatory focus on each component. Over time, each of these components shift based upon the overall projected banking environment.

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The regulatory environment is changing . . .

- Capital
  - Strong levels today
- Asset Quality
  - Preparing for an asset quality downturn
  - Bubbles
- Management
  - Focusing on Corporate governance and effective risk management
- Earnings
  - Margin compression (below 3%)
  - Inflation impact on non interest expense
  - Push back against fee income
- Liquidity
  - AOCI Issue
  - Stable vs volatile deposits (not core non-core any more)
- Sensitivity
  - Rising Rates
  - Assumptions: Betas, Decays, Prepayments
- Other
  - Heightened focus on consumer compliance
  - Approval process has slowed for M&A and de novos
  - Fair Lending and Redlining issues are increasing
  - Vendor Management
  - CFPB funding challenge is unconstitutional

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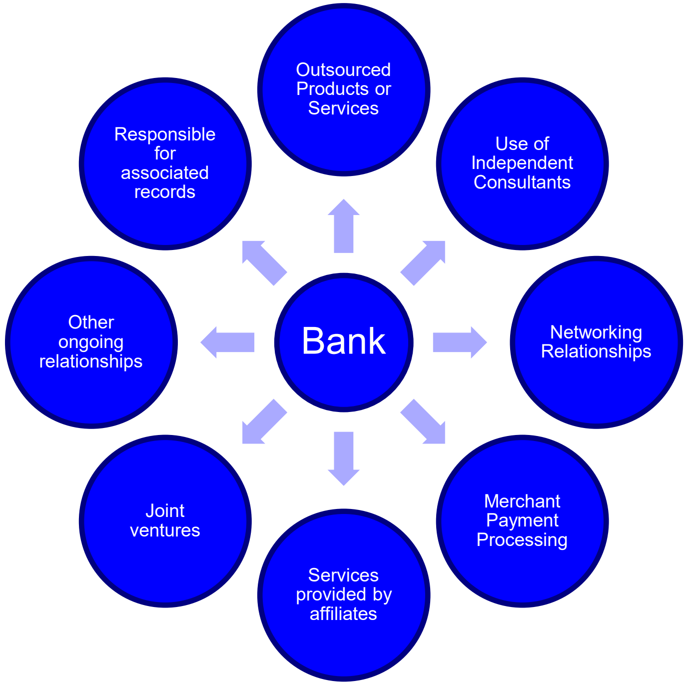
1. Be familiar with the Proposed Interagency Guidance on Third-Party Relationships: Risk Management
2. The use of third parties does not diminish the responsibilities of Board oversight
3. Request a copy of your Service Providers "Interagency Report of Examination" from your primary federal regulator
4. Tailor your risk management practices to the size and complexity of your organization
5. Establish a robust process for defining "critical activities" at your bank
6. Understand the key stages of the Risk Management Life Cycle
7. The Planning Phase should be performed BEFORE entering into a third-party relationship
8. Reliance on Subcontractors is a critical component of proper Due Diligence
9. Ensure the bank has a well constructed plan to analyze third parties when complete data is not available
10. Document, Document, Document!!!!!



- On August 29th, the Bank and the OCC entered into a formal agreement to adopt, implement and adhere to a written program to effectively assess and manage the risks posed by the Bank's third-party fintech relationships.
- This compliance committee must be composed of at least three of the Bank's directors to monitor compliance with the Agreement and make quarterly progress reports to the Bank's board of directors regarding actions the Bank has taken to comply with the Agreement and the results and status of such actions.
- This committee will:
  - Adopt, implement and adhere to an effective written Bank Secrecy Act ("BSA") risk assessment program to ensure BSA compliance risk assessments provide a comprehensive and accurate assessment of the Bank's BSA compliance risk across all products, services, customers, entities, and geographies, including all activities provided by or through the Bank's third-party fintech partners
  - Adopt a revised independent BSA audit program that includes an expanded scope and risk-based review of activities conducted through the Bank's third-party fintech partners
  - Develop, implement and adhere to an enhanced written risk-based program to ensure the timely identification, analysis, and suspicious activity monitoring and reporting for all lines of business, including activities provided by and through the Bank's third-party fintech relationship accounts and sub-account
  - Submit to the OCC an action plan to conduct a review and provide a written report of the Bank's suspicious activity monitoring, including with respect to high risk customer activity involving the Bank's third-party fintech partners, and thereafter conduct such review and provide the written report to the OCC

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Effective Risk Management

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An effective risk management framework must address the following items . . .

- Clearly identify all risks that may arise related to the institution's business (e.g., legal, credit, liquidity, operational, custody, investment, etc.)
- Establish objectives regarding the risk tolerances for the management of such risks

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All banks should be performing this assessment . . .

	Inherent Risk	Risk Mgmt Practices & Controls	Composite Risk	Trend
Credit Risk	Moderate	Strong	Low	Neutral
Market Risk	Low	Acceptable	Low	Neutral
Liquidity Risk	Moderate	Acceptable	Moderate	Neutral
Operational Risk	Moderate	Strong	Moderate	Neutral
Legal Risk	Low	Acceptable	Low	Neutral
Reputational Risk	Low	Strong	Low	Neutral
Strategic Risk	Moderate	Strong	Low	Neutral
Compliance Risk	Moderate	Strong	Low	Neutral
Notes:	Inherent Risk		Low - Moderate - High	
	Risk Mgmt Practices & Controls		Weak - Acceptable - Strong	
	Composite Risk		Low - Moderate - High	
	Trend		Decreasing - Neutral - Increasing	

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Risk Management has four separate pillars . . .

Type of Risk	Inherent Risk	Risk Management				Residual Risk	Trend
		Board and Senior Management Oversight	Policies, Procedures, and Limits	Risk Monitoring and Management Information Systems	Internal Controls		
Credit							
Market							
Liquidity							
Operational							
Legal/Compliance							
Overall							

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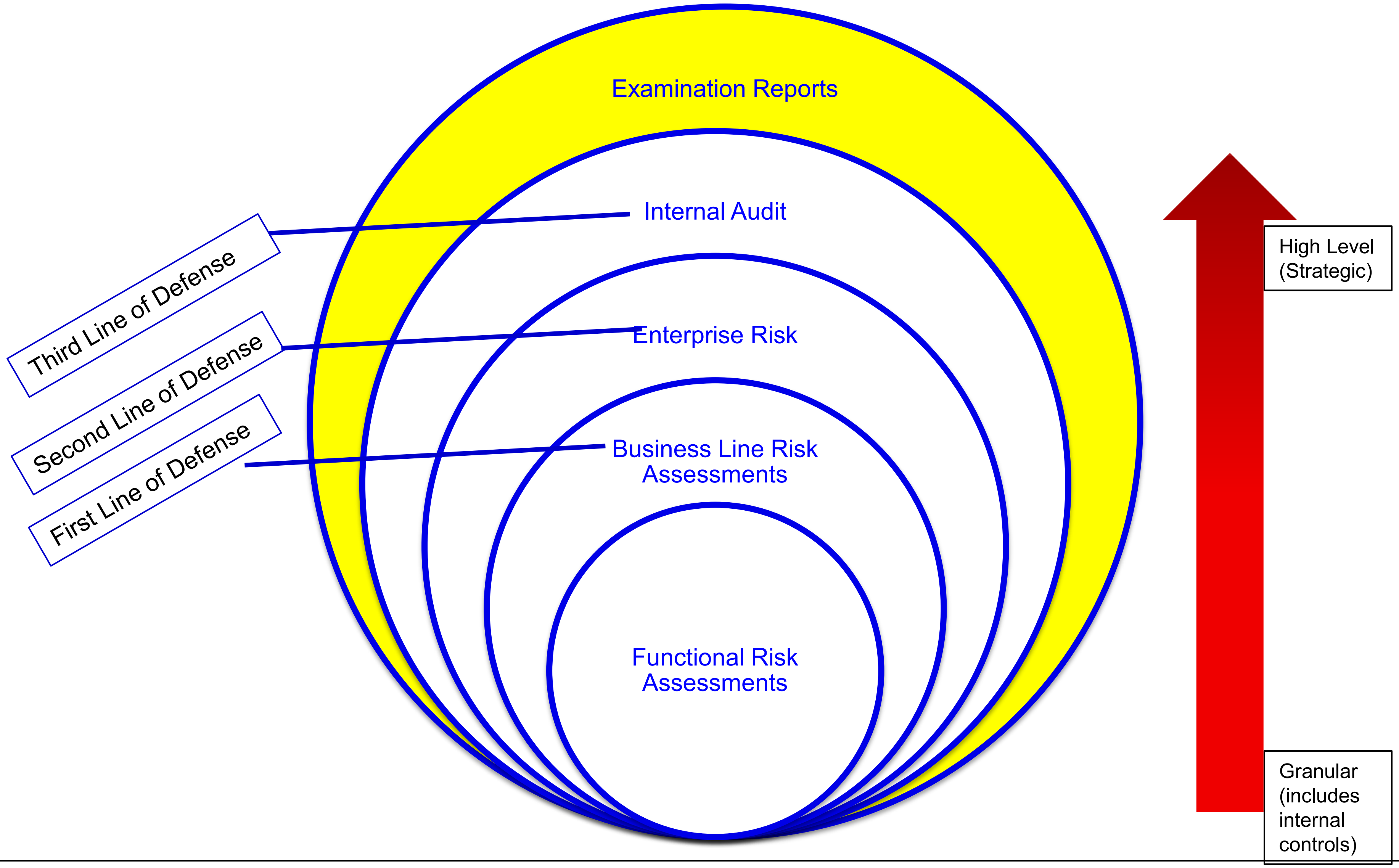
An effective Risk Management Program always has three lines of defense . . .



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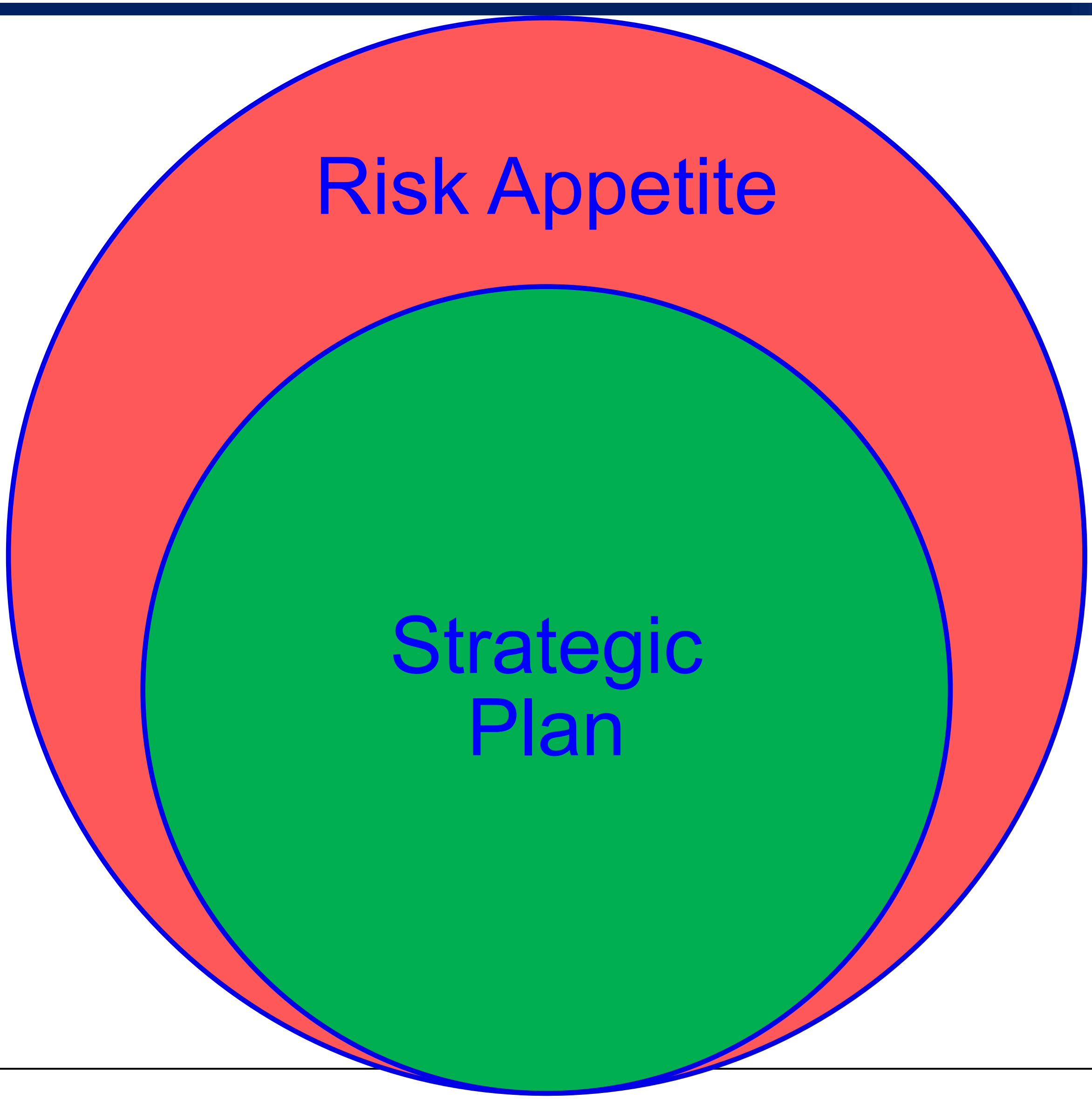
The Strategic Plan must always operate within the confines of the Board's Risk Appetite . . .



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Final Thoughts

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Bankers should:

1. Plan for two radically different economic scenarios
   a) Economic growth, if curb inflation
   b) Recession/depression, if don’t curb inflation
2. Focus on Risk (Review ScoreCard)
   a) Liquidity (Conduct a Customer Loyalty Study)
   b) Asset Quality (Conduct Loan Stress Testing)
   c) Earnings (Conduct a Detailed NIE Review)
   d) Black and Green Swan Events
3. Banks should evaluate their ability to diversify income by entering new lines of business that generate fees
4. Think outside the box and find the influencers to generate loans and deposits
5. Explore loan purchases
6. Focus on the incremental cost of funds analysis. Use this incremental cost of fund tool to run it for your specific account
7. Review cost structure in brick-and-mortar network and Mortgage Banking
8. Save money by outsourcing where possible
9. Link ALCO, planning, stress testing and risk management (or merge them into one area)
10. Focus on a reasonable IRR (10%) in 2023 that is support with cash dividends. Use Goal Builder to determine your key metrics

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