

ARKANSAS A COMMUNITY BANKER

Summer 2023

THE VOICE FOR ARKANSAS' COMMUNITY BANKS

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UCC Amended for Digital Commerce - page 38

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Hot Springs, Arkansas

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The Spirit of Togetherness

BY CHRIS PADGETT

First and foremost, I want to extend our heartfelt gratitude to each and every member of the Arkansas Community Bankers who have chosen to renew their membership. Your commitment to our community underscores the collective strength of our banking family. With your continued support, we are empowered to forge ahead, fostering connections, sharing insights, and driving positive change in Arkansas' financial landscape. Your renewal reaffirms our shared mission, and we are truly thrilled to have you as an integral part of our community. Thank you for your trust and ongoing partnership.

As we celebrate this spirit of togetherness, we invite you to join us in a series of exceptional opportunities designed to enrich your knowledge, enhance your network, and elevate your role in shaping Arkansas' banking landscape.

Bank Management and Directors Conference: An Economic Update

If this article reaches your desk in time, it's not too late to secure your place at the Bank Management and Directors Conference on August 30th, 2023, at the Clinton Presidential Library. After the fall of SVB, and others, boardrooms may face increased scrutiny from regulators. Because of that, we thought we would build this conference around topics that would benefit board members in today's enigmatic economy. We know it's hard to get out of the office. But like the gym, once you're there, you wonder why you don't come more often.

We are honored to have Arkansas' Secretary of Commerce, Hugh McDonald, who will be sharing insights into the economic dynamics of our state and the State's vision moving forward.

In addition, we have included sessions dedicated to Balance Sheet Management, Faster Payments, and insights into the current economic pulse of Arkansas and the broader banking industry, vital information that can guide

your decisions and drive your institution's growth.

2023 Compliance Conference

Looking ahead, our renowned Compliance Conference on September 26th and 27th brings bankers from three different states. Staying compliant with the ever-changing regulatory landscape is paramount, and this conference is tailored to equip your staff with the knowledge and tools to navigate the ever-changing world of compliance. Our Compliance Conference promises in-depth sessions led by seasoned experts, providing you with actionable insights to ensure your institution remains on the forefront of compliance excellence. Registration is now open!

Once again, thank you for your renewed membership and the trust you place in us. We look forward to seeing you at our upcoming events and beyond, as we journey together towards a brighter financial future for Arkansas.

Warm regards,



ARKANSAS COMMUNITY BANKER

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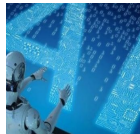
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- Our dedicated underwriters and claim professionals offer extensive industry and product knowledge.

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Coverage options

Regardless of your bank's operational scope or size, we can tailor a portfolio of coverages to meet your needs. At the same time, we'll help you reduce potential gaps and overlaps in coverage. Our products address the primary areas of exposure that impact your bank, including:

Corporate management

- Directors and officers liability
- Employment practices liability
- Financial institution professional liability
- Fiduciary liability (ERISA)

Crime

- Financial institution bond
- Kidnap and ransom

Property/casualty

- General liability
- Auto liability
- Workers compensation
- Umbrella/excess liability
- Property

CyberRisk

Surety bonds

Key benefits and features

Directors and officers liability

- Provides not only the defense costs, settlements and judgments associated with directors and officers claims, but also helps protect the personal assets of a director's or officer's spouse or domestic partner, including the deceased director's or officer's estate.

Employment practices liability

- Includes protection for an extensive array of employment practices acts.
- Coverage can expand to include directors, officers, employees, leased employees and the bank.
- Access to *Risk Management Plus-Online*®, a one-stop resource available at no additional cost that provides comprehensive tools that can help protect against costly litigation. From ethics training guidelines to coverage-specific white papers and articles, all of the materials are delivered via a dynamic web-based platform to ensure the most up-to-date information.

Financial institution professional liability

- For lender liability coverage, professional services liability and trust services liability protection, coverage extends to the bank, its directors, officers and employees.
- An expanded definition of lending acts applies, including loan servicing when the bank has an ownership interest in a loan.
- For professional services liability protection, the professional services to be included in the policy do not need to be scheduled and the coverage applies to a wide range of professional services.

Travelers knows community banks.

Fiduciary liability

- Extends to the bank, the plans, directors and officers of the bank, and any natural person trustee, director or officer of any bank-sponsored plan.
- Features an enhanced definition of covered plans, including employee benefit plans not subject to Title I of ERISA, except for multi-employer plans or employee stock ownership plans (ESOPs).

Financial institution bond

- Provides a wide range of protection for financial losses due to specified exposures, and the optional extended insuring agreements eliminate the need to carry multiple insurance policies.

Kidnap and ransom

- Coverage not only for ransom monies and the numerous costs associated with an incident, but perhaps the most important benefit, at no additional cost, is the immediate priority access to Constellis when an event occurs. Constellis is a leading provider of risk management and operational support services to government and commercial clients worldwide.
- Constellis' consultants have many years' experience in dealing with crisis situations, and this combined with their local knowledge allows for informed decisions to be made.

Property/casualty

Includes the more traditional types of property/casualty coverages, along with many designed especially for banks, such as coverage for:

- Foreclosed properties
- Trust properties
- Mail
- Repossessed autos and equipment
- Mortgage holders errors and omissions or impairment
- ATMs
- Financial leasing operations

The right policy is only one part of your insurance carrier's value. Travelers partners with you to help educate your bank on emerging and potential risks, and provides tools and solutions to better prepare your bank for the future.



The image features a hand with the index finger pointing upwards, positioned centrally. Above the hand, the word "COMPLIANCE" is written in a white, sans-serif font. The background is a dark blue night scene with out-of-focus city lights and bokeh effects. Faint, light blue geometric shapes, including hexagons and plus signs, are scattered across the upper portion of the image.

COMPLIANCE

Arkansas Community Bankers / FORVIS
2023 Compliance Conference

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September 26 - 27

**The most pressing , front-and-center compliance
topics will be discussed in great detail.**

Don't Miss It!

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2023 BHG borrower:

WA = Weighted Average

WA FICO: **736**

WA Income: **\$295,613**

Avg Loan Size: **\$142,017**

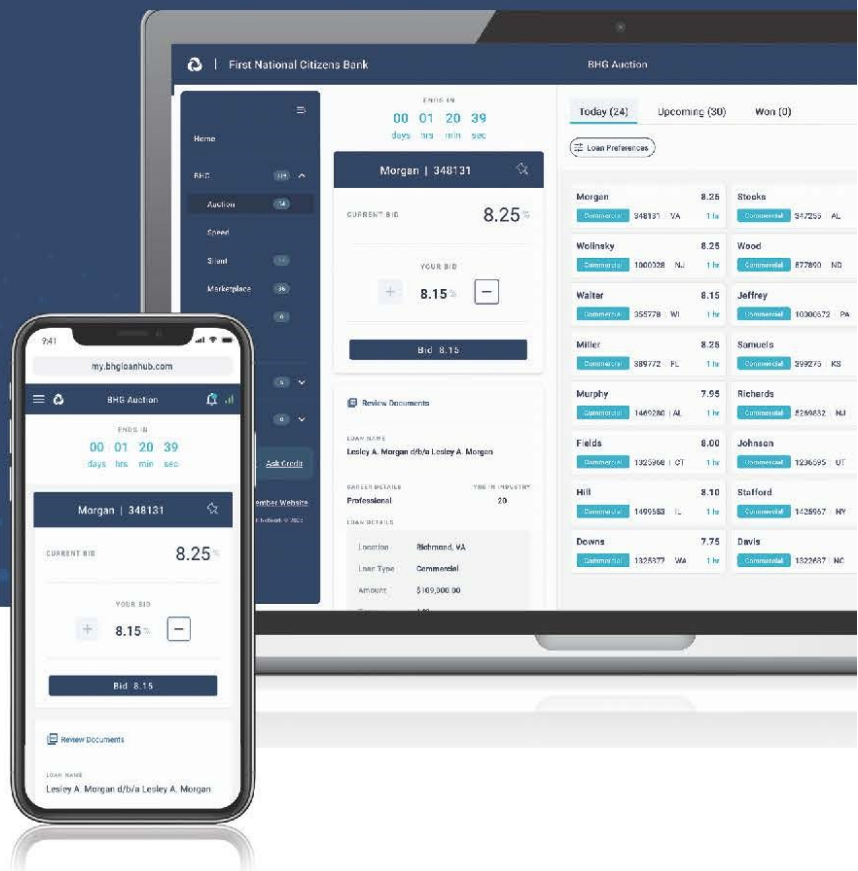
WA Years in Industry: **19**

WA DSCR: **2.26**

To learn more about
BHG, please contact:



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SECURING YOUR DATA

Advice from an award-winning cybersecurity team

By Fred Hamilton,
Chief Information
Security Officer at
BHG Financial, an ACB
Associate Member.

T

Technology continues to insinuate itself into almost every facet of our daily lives, whether it is personal or work-related. As a result, protecting data privacy has become increasingly more relevant to every consumer and business. In 2022, 422 million people were affected by data breaches at U.S. companies at an average of 4.8 breaches per day.¹ Stolen data included bank account numbers, medical histories, Social Security numbers, and more. Personal data is continuously being collected, shared, or sold, so it is

crucial that everyone understands how to protect it.

In today's world, it is incumbent upon companies to ensure they have the information security protocols in place to protect customer data and electronic assets from the growing global threat of hackers. This requires a keen focus on increasing the adoption of new technological innovations and following industry-best practices in the evolving world of cybersecurity.

Companies with an established history of successfully safeguarding electronic data often share similar characteristics, such as:

- A significant investment in people and technological resources
- Executive leadership that has demonstrated its mission to make information security and data privacy top priorities
- Next-generation firewall and encryption technology to protect internet connections and Wi-Fi networks
- Best-in-class security software installed and updated automatically
- Industry certifications and acknowledgments that appropriate security controls are in place to protect the confidentiality, integrity, and availability of all data assets

BHG Financial is a noteworthy financial services provider that has earned recognition for its exceptional cybersecurity capabilities. The company boasts a team of seasoned cybersecurity professionals who have been recognized for their outstanding contributions to the industry. In this article, we will be sharing insights from BHG Financial's cybersecurity experts on simple yet critical tasks that businesses should not overlook.

In acknowledgment of its dedication to cybersecurity, BHG and its Information Security Team recently received several industry accolades. First, it was honored with a 2022 Fortress Cyber Security Award for organizational excellence.² In addition, the company has been certified SOC 2® Type 2 compliant in accordance with standards set forth by the American Institute of Certified Public Accountants. SOC for service organizations is a compliance standard which demonstrates that BHG Financial is safeguarding customer data throughout its services and is meeting standards for strong operational effectiveness.

Security tips to protect your data from BHG Financial's Security Team

- In the spirit of driving awareness about the importance of being cyber-aware, and to help you protect the integrity of your data, here are some simple tips not to be overlooked: Avoid uploading sensitive or confidential data (personal or customer account information, Social Security numbers, etc.). If you must, all information should only be uploaded to a trusted, secure source or database.
- Be aware of any suspicious emails and do not click on unfamiliar embedded links. Be especially wary if an email contains misspelled words within the body and/or subject line of the message. Other suspicious indicators include unfamiliar email domains or enticements to act or respond immediately. Report these emails to your organization's IT

Support team right away.

- Lock your screen when you are away from your desk to prevent others from accessing sensitive information.
- Beware of public Wi-Fi. It can expose your data to scammers monitoring internet activity. It also greatly increases the risk of malware being transferred to your devices. If you must access a public Wi-Fi network, use a virtual private network (VPN) to add a helpful layer of security.
- Find out if your personal information has been targeted in a data breach. It is quick and quite easy to do. Simply enter your email or phone number at <https://haveibeenpwned.com/>. The system will respond almost immediately, detailing when and where your data was breached.
- Before disposing of old IT equipment, ensure no personal data remains on the system. Consider hiring a specialist to wipe the data from the device or use deletion software such as BitRaser File Eraser or File Shredder.

Your role in data privacy

Cybersecurity is everyone's business. With a little discipline and practice, protecting the integrity of your data can become second nature. Nobody wants to be the person who accidentally downloads malware onto their company's systems, or who leaves their online banking credentials vulnerable to external threats. Following and regularly repeating a few simple security protocols is well worth the time to remain cyber safe at home and at the office.

¹ Source: <https://explodingtopics.com/blog/data-privacy-stats>

² Source: <https://www.bintelligence.com/blog/2022/6/7/100-named-in-2022-fortress-cyber-security-awards>



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ccalderwood@bhgbanks.com





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*SBA OFFICE OF ADVOCACY, 2009

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be self-employed

than those with no active-duty military experience.



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Banks face growing regulatory pressure to address risky CRE portfolios^k

BY ALLISON BENNETT and XYLEX MANGULABNAN

US banks with large commercial real estate loan concentrations must work to proactively mitigate any potential problems or run the risk of regulatory intervention.

As concerns over commercial real estate (CRE) grow and those portfolios face headwinds, regulators have made it clear they are paying extra attention to banks with outsized concentrations and will not shy away from taking action against institutions that present risk. Those actions could include regulatory rating downgrades and increased capital retention requirements, experts told S&P Global Market Intelligence. Banks should take steps now to mitigate risk in order to avoid such actions, they said.

"The fact that [regulators are] calling this out now just heightens the need for banks to really assess how they're mitigating for those risks effectively, and not creating other problems," Peter Dugas, who heads the Center of Regulatory Intelligence at financial consulting firm Capco, said in an interview.

Although CRE loan scrutiny has always been a consistent focus for the agencies, "the pendulum is swinging more towards activism," said Carleton

Goss, counsel with law firm Hunton Andrews Kurth.

"What you're seeing is regulators saying, 'I'm not going to follow an excessively lengthy and procedural approach when I see a problem. I'm going to use the powers that I have,'" Goss said.

CRE concentrations

Banks have tightened underwriting standards on CRE loans in recent months as cautious investors looked for weakness in lenders' balance sheets following the recent bank failures.

While some real estate industry borrowers, in property types including industrial and multifamily, remain relatively stable, others have suffered in recent years. In particular, occupancy in office properties has not recovered from the COVID-19 pandemic and the rise of work from home, while labor-related expenses for health care property operators remain high in a tight job market.

In the first quarter, CRE loans made up a median of 23.8% of US banks' total loans. Generally, the nation's largest banks carried lower concentrations than smaller banks.

Among the 20 US banks with the largest CRE loan concentration at March 31, all had assets below \$6 billion. First Federal Savings and Loan Association of San Rafael topped the list, with CRE loans making up 98.3% of its total loans, and another seven community banks had more than 90% of their total loans concentrated in CRE, according to an analysis by Market Intelligence.

When narrowing the analysis to banks with more than \$10 billion in assets, CRE concentrations for the top 20 banks declined but were still elevated from the industry median. Optum Bank Inc. topped the list with 77.5% of its total loans in CRE. All but one bank on the list had at least half of its total loans concentrated in CRE.

Among the 20 largest US banks, M&T Bank Corp. subsidiary Manufacturers and Traders Trust Co. had the highest CRE loan concentration, with the segment taking up 30.4% of its total loans. Every other bank on the list reported concentrations below 20%.



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Xylex Mangulabnan is a Research Specialist for Financial Institutions at S&P Global Market Intelligence, an ACB Preferred Services Provider

US banks with the largest CRE loan concentration, Q1 2023

Company (top-level ticker)	City, state/territory	Total assets (\$B)	Total CRE loans* Proportion of total loans			
			(%)	QOQ change (bps)	YOY change (bps)	(\$B)
First Federal Savings and Loan Association of San Rafael	San Rafael, CA	0.22	98.3	2	-31	0.19
State Bank of Texas	Dallas, TX	2.13	96.5	39	311	1.65
OneUnited Bank	Boston, MA	0.61	96.0	-1	32	0.44
Piermont Bank	New York, NY	0.56	95.1	71	909	0.33
HCN Bank	Riverside, CA	0.94	93.7	-15	-14	0.65
NorthEast Community Bank (NECB)	White Plains, NY	1.48	93.2	-44	197	1.21
Malaga Bank FSB (MLGF)	Palos Verdes Estates, CA	1.50	92.4	30	53	1.19
Eastern International Bank	Los Angeles, CA	0.12	91.6	-8	-21	0.09
Universal Bank	West Covina, CA	0.36	89.9	-363	-310	0.24
United Fidelity Bank FSB (FDLB)	Evansville, IN	5.91	89.5	94	1,084	3.38
City First Bank NA (BYFC)	Washington, DC	1.20	87.4	42	1,324	0.68
Berkshire Bank	New York, NY	0.62	85.0	173	552	0.24
Bank of New England	Salem, NH	1.31	84.7	89	-53	0.96
Albany Bank and Trust Co. NA	Chicago, IL	0.70	84.5	3	216	0.46
Liberty Bank NA	Irvine, CA	0.58	84.0	-220	-680	0.40
River City Bank (RCBC)	Sacramento, CA	4.33	83.4	126	384	2.65
United Texas Bank	Dallas, TX	1.18	83.2	541	1,373	0.49
Genesis Bank	Newport Beach, CA	0.18	81.9	-39	687	0.12
First Federal Savings of Middletown	Middletown, NY	0.17	81.8	1,832	22	0.10
United Pacific Bank	City of Industry, CA	0.15	81.5	257	14	0.09
Industry median			23.8	11	36	

Data compiled June 29, 2023.
CRE = commercial real estate.

Analysis limited to operating US commercial banks, savings banks, and savings and loan associations. Nondepository trusts and companies with foreign banking organization are excluded.

* Regulators define commercial real estate loans as construction and land development loans + multifamily loans + nonowner-occupied nonresidential property loans + commercial real estate loans secured by collateral other than real estate.

Data based on regulatory filings.

Source: S&P Global Market Intelligence.

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Largest CRE loan concentration at US banks with total assets greater than \$10B, Q1 2023

Company (top-level ticker)	City, state	Total assets (\$B)	Total CRE loans ¹			
			Proportion of total loans		YOY change (bps)	(\$B)
			(%)	QOQ change (bps)		
Optum Bank Inc. (UNH)	Draper, UT	16.02	77.5	-339	112	3.30
Dime Community Bank (DCOM)	Bridgehampton, NY	13.83	73.0	-3	-54	7.83
Bank OZK (OZK)	Little Rock, AR	28.97	72.9	-58	-149	16.09
Farmers & Merchants Bank of Long Beach (FMBL)	Long Beach, CA	12.02	71.4	11	394	4.87
EagleBank (EGBN)	Bethesda, MD	11.04	66.5	228	538	5.17
Provident Bank (PFS)	Iselin, NJ	13.77	64.0	-11	167	6.54
Pacific Premier Bank (PPBI)	Irvine, CA	21.36	60.7	70	66	8.64
Lakeland Bank (LBAI)	Newfoundland, NJ	10.84	58.4	37	12	4.64
First Foundation Bank (FFWM)	Irvine, CA	13.59	57.9	13	-109	6.18
Flagstar Bank NA (NYCB) ²	Hicksville, NY	123.63	57.8	-1,121	-3,285	48.49
Merchants Bank of Indiana (MEIN)	Carmel, IN	13.95	57.4	-159	604	6.57
Independent Bank (IBTX)	McKinney, TX	18.79	56.0	24	213	7.85
Apple Bank for Savings	New York, NY	16.89	55.3	126	117	6.32
Valley National Bank (VLY) ³	Wayne, NJ	64.31	54.5	73	236	26.55
OceanFirst Bank NA (OCFC)	Toms River, NJ	13.45	53.8	47	245	5.40
Sandy Spring Bank (SASR)	Olney, MD	14.13	53.3	-17	60	6.08
Citizens Business Bank (CVBF)	Ontario, CA	16.27	51.0	140	228	4.56
Axos Bank (AX)	San Diego, CA	18.94	50.4	-92	320	8.08
First Bank (FBNC) ⁴	Southern Pines, NC	12.37	50.1	-110	107	3.91
Rockland Trust Co. (INDB)	Rockland, MA	19.45	49.1	-12	-242	6.85
Industry median⁵			23.8	11	36	

Data compiled June 29, 2023.

CRE = commercial real estate.

Analysis limited to operating US commercial banks, savings banks, and savings and loan associations with total assets greater than \$10 billion as of March 31, 2023. Nondepository trusts and companies with foreign banking organization are excluded.

¹Regulators define commercial real estate loans as construction and land development loans + multifamily loans + nonowner-occupied nonresidential property loans + commercial real estate loans secured by collateral other than real estate.

²Flagstar Bank NA purchased certain assets and liabilities of Signature Bridge Bank NA on March 19, 2023.

³Valley National Bank parent Valley National Bancorp acquired Bank Leumi Le-Israel Corp. on April 1, 2022.

⁴First Bank parent First Bancorp acquired GrandSouth Bancorp on Jan. 1, 2023.

⁵Analysis limited to operating US commercial banks, savings banks, and savings and loan associations. Nondepository trusts and companies with foreign banking organization are excluded.

Data based on regulatory filings.

Source: S&P Global Market Intelligence.

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"We have a long-standing expectation, this is interagency, that CRE-concentrated banks should look at their own performance in a downturn. And so we're scrutinizing that very vigorously," Todd Vermilyea, senior associate director of the Fed Board of Governors Division of Banking Supervision and Regulation, said June 16.

Martin Gruenberg, chairman of the Federal Deposit Insurance Corp., said at the release of the FDIC's most recent Quarterly Banking Profile that CRE would be a significant focus for his agency, calling it "a matter of ongoing attention in our supervision work."

Speaking at S&P Global Market Intelligence's Community Bankers Conference in May, an FDIC examiner cautioned that the agency will take a hard look at internal risk assessments, reserves and capital positions for banks with high CRE concentrations.

However, the intensity of regulators' scrutiny depends on a number of factors.

For example, states that encourage flexible return-to-work policies or have a lot of technology and other companies that make it easier for employees to work from home pose more risk, Capco's Dugas said.

"When it comes to CRE, it's really going to be a regional issue," Dugas said.

"When you look at banks that are operating in states like Florida and Texas and some areas within the South ... they're in much better shape than states like California or New York or Illinois."

Moreover, office is seen as a higher risk than other property types.

"Not all commercial real estate is the same. A high-rise office building in a big city is different than an owner-occupied mom-and-pop business on Main Street," said James Stevens, co-leader of the financial services industry group at Troutman Pepper.

Wherever supervisors see "very significant risk concentrations that aren't being handled properly," they will take swift action, according to Goss of Hunton Andrews Kurth. Such consequences include ratings downgrades and supervisory agreements, he said. They could also require banks to raise additional capital, Goss said.

To prepare for the enhanced scrutiny, banks should work now to proactively address any risk before it is identified by regulators, bank advisers said.

Financial institutions should be asking themselves, "Do I have concentrations of any of these [risky] kinds of properties, or any risks geographically by asset class? Is there anything at my bank that could be an issue, and if there is, what should I be doing to mitigate that?" said Matthew Bisanz, partner with Mayer Brown's financial services regulatory and enforcement practice.

Banks can mitigate risk with interest rate hedges or by slowing their lending, Bisanz said. Those are actions "that a banking regulator might press a bank to do based on a concern that exposure to a portion of the CRE market is too large," Bisanz said.



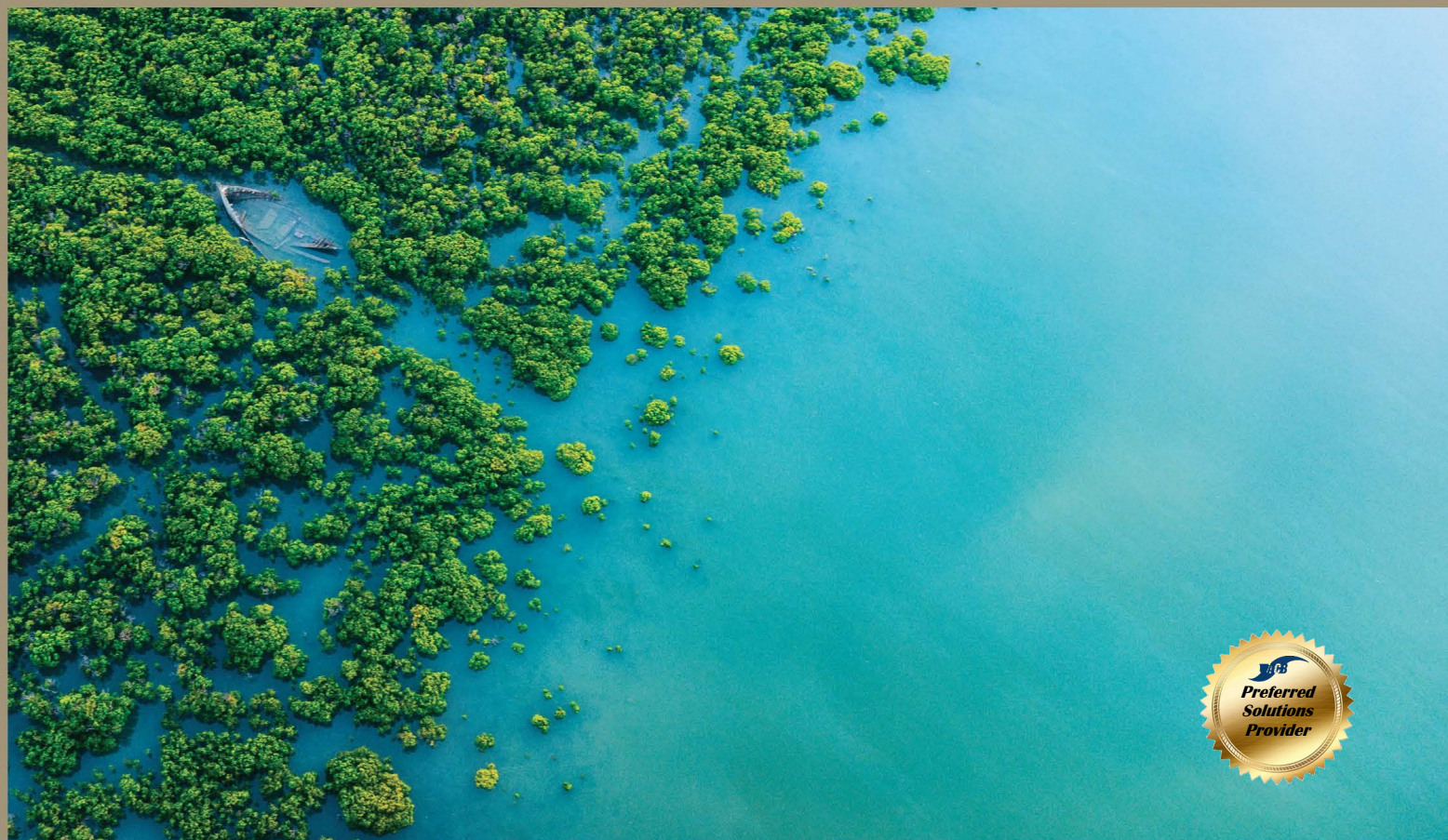
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Value, added

High baseline yields accompany surprisingly wide spreads



Jim Reber is president and CEO of ICBA Securities, an ICBA subsidiary and ACB Preferred Services Provider. You may connect with Jim at (800) 422-6442 or jreber@icbasecurities.com.

If your responsibilities include your community bank's bond portfolio, you've been confounded by several elements of its performance in the last 18 months.

To the extent your portfolio has mortgage-backed securities (MBS) and government agency bonds, and the clear majority of all bonds owned by banks are in these two categories, they've certainly lost value since 2022. It is easy enough to put the "blame" on the Fed's Federal Open Market Committee (FOMC), which as of this writing has taken overnight rates up fully 500 basis points (5%) since March of last year.

However, something else has occurred in period that's contributed to the decline in bond prices: Yield spreads have actually *widened* during this time frame, which is highly unusual for a rising rate scenario. It has aggravated the market losses in community bank portfolios, which stood at around 8% as of June 30. About one-fifth of the market losses can be attributed to spread widening. What's going on here?

Maybe it's time to review why spreads widen and tighten, and why the various bond market sectors behave differently. If we can conclude with the notion that there are some opportunities for long-term benefit for your bank, all the better.

Spread basics

First, a refresher on "spreads" in this context. It is the incremental yield for a collection of bonds, over and above the benchmarks. The benchmarks are comparable maturity Treasuries, which are presumed to be risk-free. (We don't have time here to revisit the recent elaborate game of chicken over the debt ceiling. Notice I said "elaborate" and not "elegant.")

Incremental spreads on bonds will tend to widen as rates fall, as lower yields accompany an economy that is losing momentum. This slowdown brings with it a higher likelihood of debt service problems, so lenders, including bond investors, ask for additional yield protection.

In 2023, there's no slowdown, yet, and so the FOMC has now hiked overnight rates to their highest levels in 15 years in its quest to get inflation under control. And still, spreads are wider in virtually all bond sectors, so something different is in play. One factor is the Fed's posturing related to its own balance sheet. Currently, the Fed is removing \$95 billion per month from its own Treasury inventory. It has

reserved the right to actually shed some of its \$2.5 trillion MBS portfolio, but hasn't yet.

Another difference this time around is the well-documented decline in excess liquidity on bank balance sheets, which I hasten to add is not the same thing as deposit runoff. Globally, the banking sector has gone from too much uninvested cash, to probably about right. Again, this has removed some demand from the fixed-income markets as the banking sector has purchased very few bonds in 2023.

Some sectors are not like others

The callable agency market gives us a good example of how spreads are historically wide. Way back in 2021 (hyperbole), a bond that matured in three years and could be called in a year ("3/1 callable" in bond-speak) would have had a stated rate of interest of around 0.50%, which was about 10 measly basis points (0.10%) over the curve. Today, the "coupon" for the same bond would be around 5.50%, which has a full 1% spread over the three-year Treasury.

Similarly, popular mortgage securities have improved yields and spreads today, over just a few months ago. A staple of community bank portfolios is a 15-year MBS issued by Fannie Mae or Freddie Mac. A "current coupon" pool has right at a 5% yield to maturity, again around 1% over the Treasury curve. A year ago? A current coupon would have been about 3.5%, and its spread around half of today's.

Act now, thank you

It's time to speak into the microphone and state that things can get worse before they get better. Which is to say, Treasury yields, and spreads, can continue to gap higher and wider before coming back in line. The Fed sure doesn't sound like it's finished with tightening, and even though banks are making use of wholesale funding sources to maintain liquidity levels, banks aren't likely to become deluged with excess cash in the near future.

Nonetheless, we have a baseline of yields (Treasury curve) that is at a 15-year high, coupled with spreads that are nearly unprecedented for this stage of the rate cycle. This causes me to suggest that your portfolio will thank you later for bonds you purchase in mid-2023. If more yield is considered good, then it's summertime, and the livin' is easy.



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A Key Trait of a High-Performing Bank - a Culture of Awareness

BY JASON CORDER

If you ever read automobile reviews in websites or magazines like *Car and Driver* or *Motor Trend*, you probably know that there are different factors that make a sports car an “outstanding car.”

Some of these things are obvious and measurable, such as horsepower, torque, acceleration times, and stopping performance. There are other traits that are not as obvious on paper and can be harder to measure. Things such as how a car handles, the optimal level of driver feedback, and the comfort of a car are difficult to measure but are very important to what makes a car an outstanding car. In the same way, most high-performing banks have several identifiable traits that are easy to recognize by looking at performance ratios and measurements. These traits, shown on a report like the *Uniform Bank Performance Report* (UBPR), include a strong Net Interest Margin, indicating that a bank's interest incomes and interest expenses are effectively managed. Another indicator typically present at a high-performing bank is a low “Net Losses to Average Total Loans and Leases” ratio which, along with low past due ratios, speaks to management's effectiveness in overseeing credit risk. Another trait one sees in a high-performing bank is a lower-than-peer Efficiency Ratio, which shows that management has established a good balance between net interest income and noninterest income against overhead expenses.

There are other traits present in a high-performing bank that are not as straightforward. These traits are more subjective, a little more “touchy-feely.” Traits such as providing an excellent customer experience and engaging in beneficial community involvement can lead to strong financial performance, but these traits have more to do with a bank's culture rather than financial data. In our firm, which works with over 150 banks in thirty states, we've noted that high-performing banks nearly always have a “culture of awareness.” Awareness is defined as “knowledge and understanding that something is happening or exists.” This concept of awareness can be applied at every level of a bank, whether it is knowing which customers are the most profitable and least profitable and responding appropriately, awareness of changes in the local market that might impact a bank's customer base, or an understanding of trends in bank technology that may require a bank to make strategic shifts to accommodate those changes. Establishing a culture of awareness is especially important in the areas of security and risk identification/risk management. Each of these areas are interrelated, and security awareness can be considered a component of risk management. Developing an enterprise-wide culture of awareness in these areas can result in an engaged Board of Directors, knowledgeable bank personnel, and connected customers.

Security awareness has been necessary since the dawn of banking. However, security risks are constantly changing, and the prolific and evolving threats from cybersecurity should continue to be a primary focus of bank management. The Federal Deposit Insurance

Corporation (FDIC) noted in its *2022 Risk Review* that the operational risk from cyber threats and illicit activities is a “key risk to banks.” The FDIC stated that “Operational risk in banking is one of the most critical risks to banks. Cyber attacks continue to evolve, become more sophisticated, and multiply as bad actors discover creative ways to exploit technological and operational vulnerabilities.” Having a culture of awareness is a vital step in addressing information security and cybersecurity risks. Bank networks, systems, and levels of access should be configured in such a way that cybersecurity-related risks are minimized. Having a robust security awareness program works in a complementary way with technical controls and can supercharge a bank's ability to effectively prevent and respond to information security and cybersecurity threats.

A robust security awareness program typically has a few defining characteristics. The most important aspect of a security awareness program is a top-down emphasis from the Board of Directors and senior management. This means that management understands and prioritizes security. This results in adequate resources and training for those directly responsible for a bank's security and for bank personnel as a whole. Bank personnel will see that ongoing training and testing programs are prioritized activities rather than simply “check the box” activities. Outside expertise will be engaged as needed to conduct training and testing. Those occasions when employees' awareness is lacking (i.e., failing phishing tests or not shredding sensitive customer information) will be seen as opportunities for effective education rather than “name and shame” events. Employees can then be a part of the bank's frontline defenses in the same way that they are for customer service. Additionally, employees that are knowledgeable about security can be more effective in training a bank's customers on how to use bank products safely and securely.

At a broader level, having a culture of awareness concerning risk management is essential in a high-performing financial institution. Our firm facilitates risk assessments for enterprise risk, information security, cybersecurity, business continuity, digital banking, vendor management, and several other areas, and the purpose of these risk assessments is **awareness**. What assets (e.g., systems, information) does the bank have? What are the threats to those assets? What is the likelihood of those threats occurring? What is the magnitude of impact should threats occur? What are the mitigating controls to reduce the risk from those threats? What is the residual, or remaining, risk after considering the bank's controls?



Jason Corder is a Senior Vice President with Sawyers & Jacobs LLC, a consulting firm focused on serving financial institutions. Sawyers & Jacobs is an ACB Associate Member. Jason may be reached at 901-828-1942 or jcorder@sawyersjacobs.com.

Continued on Page 20



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Lastly, what is the bank's risk response? Knowing the answers to these questions and verifying that measured risk levels align with the Board of Directors' **clearly defined** and **clearly communicated** risk appetite results in an awareness of what actions need to be taken to maintain acceptable levels of risk. Such risks might be threats such as ransomware attacks or unauthorized access to bank systems, but it could also be risk to the Bank's reputation because the bank's online banking system is clunky or experiences frequent downtime. A culture of awareness results in the correct people being **promptly informed** when a risk is elevated and in **corrective action** to bring the risk back to acceptable levels.

One final thought: if you have a high-performing (and expensive) sports car, you will want a competent mechanic who specializes in keeping your make and model of car at a level of optimum performance. In the same way, having the right partner to provide expertise in reviewing the quality of the bank's oversight for the bank's systems, security, risk management, and awareness is incredibly important for maintaining the bank's level of high performance. As you work to identify that important strategic partner, consider factors other than price. For example, the vendor providing your IT audit should be someone you rely on to assess the state of your bank and make recommendations that help to make the bank better. While reasonable pricing is important, like engaging your bank's legal counsel this is not an area where it's wise to simply put the work out for bid and choose the low-cost provider; instead, bank-specific expertise, firm reputation, and experience should weigh heavily in your decision. And, ultimately, this helps the bank to have a stronger culture of awareness, which can lead to a higher-performing bank and a smoother ride across an increasingly competitive and uncertain landscape!

1 <https://www.merriam-webster.com/dictionary/awareness>

2 <https://www.fdic.gov/analysis/risk-review/2022-risk-review/2022-risk-review-section-3.pdf>



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A New Risk Management Tool for Community Banks

BY BRENT MELTON

HISTORY - Over the years Methods, Policies and Procedures in Banking have changed due to competition, regulations, customer demands, risks and finally economics. The banks of old, along with the policies and procedures are not the same in the banks of today. In order to stay

relevant, banks have had to evolve with market conditions, customer trends, advances in technologies, and different types of risks.

TODAY, we will discuss how DATA VISUALIZATION has allowed the banking industry to evolve in managing exposure to RISKS hidden in Property Descriptions. Banks typically use One of Four methods below to validate a written property description.

Action	Risk Level
They hire a surveyor	Low
They rely on title insurance	Moderate
They assume the description is correct	High
Use County online maps	High

The best option here is to hire a surveyor to reduce RISKS regarding errors, however a new RISK has now been introduced – increasing the cost to the customer. Title Insurance ranked moderate due to the fact that most policies have a schedule B that eliminates coverage for property descriptions. County Maps rated high in risks because the county does not have the description that the bank has on file. Lastly assuming the description is correct ranked HIGH because well, you know why.

THERE IS NOW A FIFTH OPTION - DATA VISUALIZATION

What is Data Visualization? Simply put – Data Visualization is: Pictures instead of letter and numbers, Layers instead of file folders, Legacy data merged with current data to create and understand the operating picture.

Real use example of a type of data visualization – “Property Descriptions”. These descriptions are a very important part of the loan process. Without a solid property description, the banks’ exposure increases dramatically. Analysis over the last 8 years has found that 17 to 20 percent of property descriptions studied had at least one error causing the property description to be invalid. (Sample size 20,000 descriptions)

In order to reduce the banks RISK, you must be able to answer these questions at a minimum.

- Does your polygon close?
- Are there multiple parcels?
- Is the acreage correct?
- Is your property located where you think it is?
- Are your improvements on your property?
- Are your partial releases correct?

- Is your ingress/egress located properly?

Traditionally you would have a property description similar to the one below in your closing file. The question is, by reading this description can you answer the questions above with a high level of confidence? Some of you might be saying “I use county online mapping systems so I am ok”. Whereas county records are a great way to get an idea of what you might be lending on, they do not use the same information that you are about to put in your file. Remember you need to ensure the document in your file is the correct description for what you are lending on.

1. LEGAL DESCRIPTION: 575 +/- acres being in the N 1/2 (Less area east of Hwy. 16) & NE 1/4 of SW 1/4, & N 1/2 of SE 1/4 of Section 1 & NE 1/4 of Section 2, T9N, R2E, & parts of W 1/2 of Section 6, T9N, R3E, Madison County, Mississippi, together with all oil, gas, and mineral rights, if any

Visualization of a property description

The text has been transformed into a picture then placed geographically on an image. The picture was generated using all of the information found in the deed and polygons are created representing the target parcel (s), less and excepts, easements etc.... The image also allows you to be able to improvements located on the property. In a matter of seconds, the loan officer should be able to confirm the answers to the questions we discussed earlier resulting in faster loan processing.



With every passing year there are new technologies and new processes that improve on the time-tested ways of years past. Data Visualization has emerged in numerous other sectors and has been proven very successful in managing expectations, quantifying data and reducing risks. Now this technology is available to the community banking industry.

Benefits of Data Visualization – Reduced RISK to the BANK – Reduced RISK to the CUSTOMER- Fast turnaround time – Repeatable Results – Low-Cost Solution.



Brent Melton is CEO and co-founder of Vizaline, LLC, a company specializing in converting property descriptions into pictures. Vizaline is an ACB Associate Member. You may connect with Brent at brent@vizaline.com.

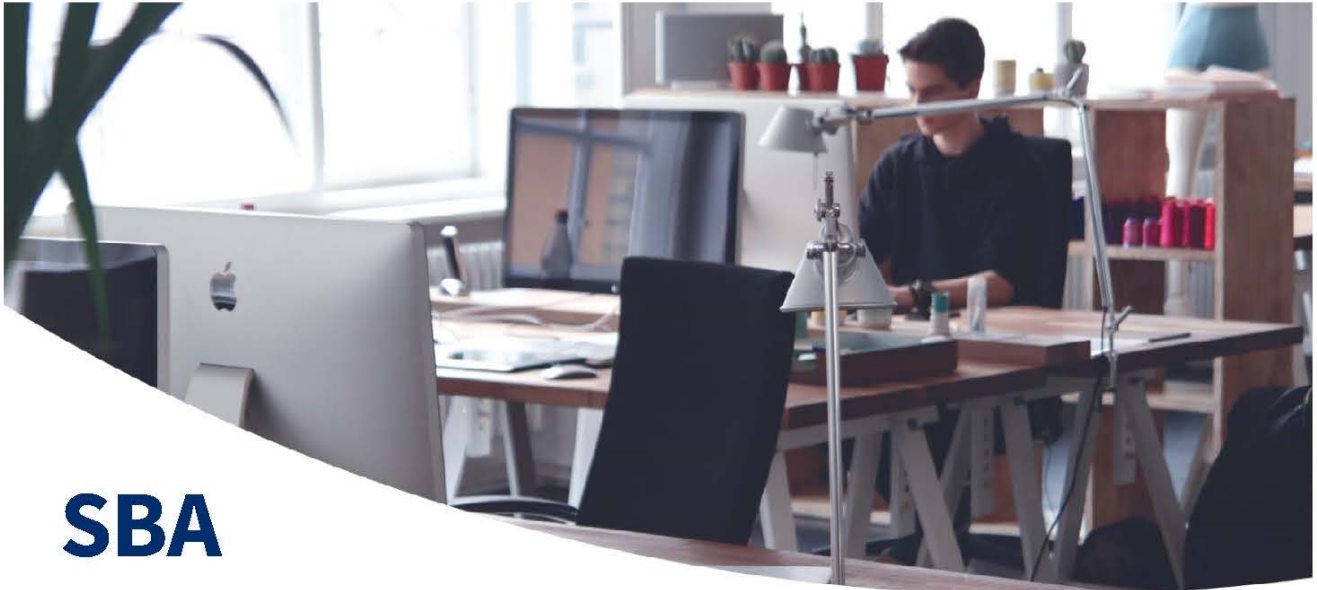
“DV has identified many problems in our legal descriptions which in turn allowed us to have the issues corrected before closing. It has also helped us clean up our existing loan portfolio by examining legal descriptions during the refinance process.”

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Exempting Community Banks from FDIC Assessments:

Strengthening Local Economies and Preserving Financial Diversity

BY ChatGPT

Continuing with our fascination with the new artificial intelligence platforms, we've decided to include articles for a few editions relating to current issues that will be written by ChatGPT.

Our instructions were to "write 1,500 words about exempting community banks from FDIC special assessments". In less than one minute the following article appeared as "What AI Says".



In recent times, the banking industry has witnessed several failures, leading to the need for the Federal Deposit Insurance Corporation (FDIC) to replenish its insurance fund. The FDIC plays a crucial role in maintaining depositor confidence and safeguarding the financial system by insuring deposits in member banks. However, community banks, which serve as the backbone of local economies, face unique challenges in comparison to their larger counterparts. In light of these disparities, this article argues for exempting community banks from assessments to replenish the FDIC insurance fund after recent bank failures. Such an exemption would enable community banks to thrive and continue serving their communities without undue financial burden, preserving financial diversity and promoting economic growth.

I. The Vital Role of Community Banks in Local Economies:

Community banks are integral to local economies as they focus on serving the needs of small businesses, individuals, and households within specific communities. These banks are better equipped to understand the unique challenges and opportunities faced by local businesses, thereby providing tailored financial services and fostering economic growth.

A. Local Business Support:

Community banks have a more profound understanding of the local business landscape, allowing them to make well-informed lending decisions that contribute to job creation and the overall economic development of the community.

B. Enhanced Consumer Relationships:

Being embedded within the community, community banks are able to build strong relationships with their customers, leading to better customer service and greater financial education for individuals and families.

II. Impact of Bank Failures on Community Banks:

Recent bank failures have resulted in a burden on the FDIC insurance fund, which aims to protect depositors in the event of a bank's collapse. However, community banks' involvement in these failures has been relatively minimal compared to larger financial institutions.

A. Disproportionate Impact:

The current assessment system for replenishing the FDIC insurance fund does not take into account the size and scale of individual banks.

Community banks, despite contributing insignificantly to the failures, may bear a significant proportion of the cost.

B. Financial Constraints:

For community banks operating on limited profit margins, such assessments can strain their financial resources, potentially leading to reduced lending capacity and constrained local economic activity.

III. Advantages of Exempting Community Banks:

Exempting community banks from FDIC assessments could bring about numerous benefits for both the banks and the communities they serve.

A. Preserving Financial Diversity:

Community banks offer an alternative to large, centralized financial institutions, promoting financial diversity and competition. By reducing regulatory burdens, these banks can continue offering unique and localized services to their customers, fostering a resilient and diverse financial ecosystem.

B. Boosting Economic Growth:

When community banks are not burdened with additional financial obligations, they can focus more on their core functions, such as lending to small businesses and supporting local initiatives. This, in turn, stimulates economic growth and job creation.

C. Strengthening Depositor Confidence:

The exemption of community banks from FDIC assessments would enhance depositor confidence, as customers would have reassurance that their local banks are not unduly strained by external factors.

IV. Counterarguments and Mitigation:

Critics may argue that exempting community banks from FDIC assessments could create potential risks and imbalances in the financial system. However, it is essential to consider ways to mitigate these concerns.

A. Risk Management:

Community banks should continue to adhere to prudential regulations and risk management practices to ensure stability and prevent undue risk-taking.

B. Gradual Implementation:

Exemptions could be phased in gradually to allow a measured evaluation of the impact on the financial system and make necessary adjustments if needed.

Conclusion:

Community banks play an indispensable role in supporting local economies, fostering financial diversity, and enhancing depositor confidence. Exempting these banks from FDIC assessments to replenish the insurance fund after recent bank failures is a reasonable step to ensure their continued success and contribution to economic growth. By preserving the unique role of community banks, policymakers can create a more robust and inclusive financial system that benefits both local communities and the nation as a whole.



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Continuous Innovation

- Agile company that delivers development in a more timely and tailored fashion with deployments held every two weeks
- 198 custom enhancements for our partners so far in 2021
- Have an open dialogue with our bank partners to prioritize their needs, not tied down to user groups

Solid History & Strategic Growth

- Founded in 2002 out of need for better software and exceptional service
- President & CEO's father founded Systematics in 1968
- Recognized as the 2nd Best Place to Work in FinTech by *American Banker* in 2021
- Bank partners located from coast to coast

Product Features

- Vertically integrated solution that includes core processing, general ledger, teller system, digital banking for consumer & commercial, item processing, document images, robust reporting and much more
- Allows for better access to information, more simple business processes and a more secure product
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“So much of what we’ve seen in the last six months is banks doubling down on what they’re good at doing: helping their customers and communities in ways that nobody else can.”

As we enter budget season, the adage “You can’t save your way to prosperity” hits home. With regulatory and financial pressures, community banks face tough decisions as they allocate resources for 2024.

I was just speaking with a banker who reiterated that it’s been a while since we’ve been in this interest rate environment, and its impacts on the cost of credit and renewals send us down a path of unknowns. So, when we begin budgeting, we have to find a meaningful way to anticipate what lies ahead.

But with this uncertainty comes an opportunity to look at solutions with a new perspective. The current economic environment has bank management teams laser-focused on how we grow and create new revenue, all while managing expenses. The reality is that interest expenses will be significantly higher moving into the coming year, so we need to be asking, “What are we doing on the other side of the income statement to grow revenues?” Now’s the time to think outside the box to ensure we continue to grow.

Whether it’s stories of banks continuing to increase deposit balances based on trusted relationships in the community or others who are introducing different types of deposit products or identifying continued loan

growth despite economic challenges, so much of what we’ve seen in the last six months is banks doubling down on what they’re good at doing: helping their customers and communities in ways that nobody else can.

Community banks are building on their tried-and-true relationship-based business models, exploring opportunities for new sources of revenue generation, whether of payment products, specialty or niche areas of finance, or seeking other solutions that speak to individual customer bases.

So much of what we do in budget season is “put your head down, plug in the numbers and proceed forward.” But pulling out of the weeds allows us to see how we can take advantage of this time and think creatively about how we’re innovating for the future of our organizations.

And we’re not in it alone; we have a network of community banks on which we can rely. In fact, ICBA has just launched ICBA Community (community.icba.org), a digital platform to help community bankers network and share information. I encourage you to use it to get insights into creative ways your peers are managing this budget cycle.



Where I’ll be this month

I’ll be speaking at the Bluegrass Community Bankers Association and Indiana Bankers Association conferences, encouraging bankers to continue using their peer network as they think about the future.



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A graphic for "Webinar network" featuring a blue and white design with a gear-like border. It includes the text "COMMUNITY BANKERS Webinar network" and "Relevant Reliable Cost-effective". A QR code is in the bottom right corner.



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The Human Side of M&A

BY PHILIP K. SMITH and CHARLES PLUNKETT



Philip Smith is Chairman & CEO of Gerrish Smith Tuck, Consultants and Attorneys an ACB Associate Member. You may connect with Philip at (901) 767-0900 or psmith@gerrish.com.



Charles Plunkett is an attorney with Gerrish Smith Tuck, an ACB Associate Member. You may connect with Charles at (901) 767-0900 or cplunkett@gerrish.com.

As a member of a bank board of directors or as an executive officer, you may have had the opportunity to participate in the M&A process at the highest level.

However, for all boards, as well as the Board Chair and executive management, whether on the buy side or sell side, we must not lose focus of the human side of M&A. Even if “the numbers” of a potential transaction look great to your institution, if you wind up with a post-transaction issue from the employees (disgruntled employees that lose their job, remaining employees who have fewer benefits, people generally dissatisfied with any change in the organization, etc.), then the projected numbers and value you are expecting may not materialize. So, you have to get the human side of M&A correct on the front end as well.

From a selling organization standpoint, the human side of M&A means making sure you protect the people that need to be protected and giving a benefit to long-term employees who might lose their job. It is pretty common for a potential selling organization to put contracts in place for certain key individuals that provide them a change in control payment upon completion of a transaction, or provide certain benefits in the event the employee is terminated. In addition, there may be circumstances where previous stock awards will accelerate and vest, or any of a number of different tactics that are important to your remaining employees. The key question a seller will always ask is whether that additional cost will come right out of the shareholder’s pocket because the buyer will reduce the purchase price by those amounts. That certainly is possible, and a buyer will generally factor in those elements when looking at a target, but the nominal per share decrease in value that might be realized is normally inconsequential to doing the right thing by your employees. Most savvy buyers recognize the benefit of those costs being incurred. It can even be a negotiated factor as to whether those costs are borne by the buyer or the seller.

If you are on the buy-side of a transaction, particularly for community banks, understanding that the seller’s employees are going to be very nervous about the transaction and doing what you can to put their fears at ease (while being honest with them) will go a long way to preserving the value of the transaction that you expect to realize. This may mean adding additional contracts as protection for you, as the buyer, such as a retention bonus payment. This type of agreement rewards an employee who stays through the closing of a transaction, and normally for some period of time afterwards. This may not even be top level executives, but could be an IT person, a compliance person or someone similar where you as the buyer really need that person’s expertise through closing and for some period of time afterward. In addition, if there are other key employees you absolutely know you want to have continue with the organization, it is often a benefit to talk to them as early in the process as possible, offer assurances or maybe even offer new employment contracts.

These concerns also factor into how you conduct the financial analysis.

A major component for both buyer and seller in analyzing the financial aspects in a transaction revolve around anticipated cost savings. Typically, any cost savings in a transaction are expressed as a percentage of noninterest expense of the target. So, for example, a buyer might assume, as a rule of thumb, a 20% cost savings of the target organization’s non-interest expense. That is a fancy way of saying there is at least 20% savings in fixed assets (perhaps closing branches) or in personnel cost (meaning that not everyone is going to stay after the deal is done) or other cost savings like directors’ fees of the target that will be saved through a merger of the organization. So, it is important for both organizations to understand that cost savings number. As the board or executive of a potential selling organization, if a buyer is telling you they do not expect any material change in personnel, yet they are factoring in a 35% cost savings, it is a reasonable question to ask the source from which those cost savings will be achieved. Similarly, a buyer needs to be brutally honest with itself in assessing potential cost savings and, perhaps more importantly, honest about whether the buyer has the “stomach” to actually implement cost saving measures.

Far too often we have seen a buyer, for example, assume a 20% to 25% non-interest expense cost savings. That sounds good on paper, but there needs to be some specificity as to where those savings come from. Often, a buyer finds after making the acquisition that to really generate those true cost savings, someone is going to need to go fire George, who has been with the bank almost 40 years, or Mrs. Sarah, whose great-uncle started the bank. When a buyer then decides not to do that, the anticipated cost savings are not in the transaction and therefore the economic benefits expected do not come to pass. So, it is an important reminder that, for all of the number crunching in the world that you can do to analyze a transaction as either a buyer or a seller, you absolutely cannot overlook the human element of M&A and its impact either socially, culturally or financially in bringing about a successful transaction.

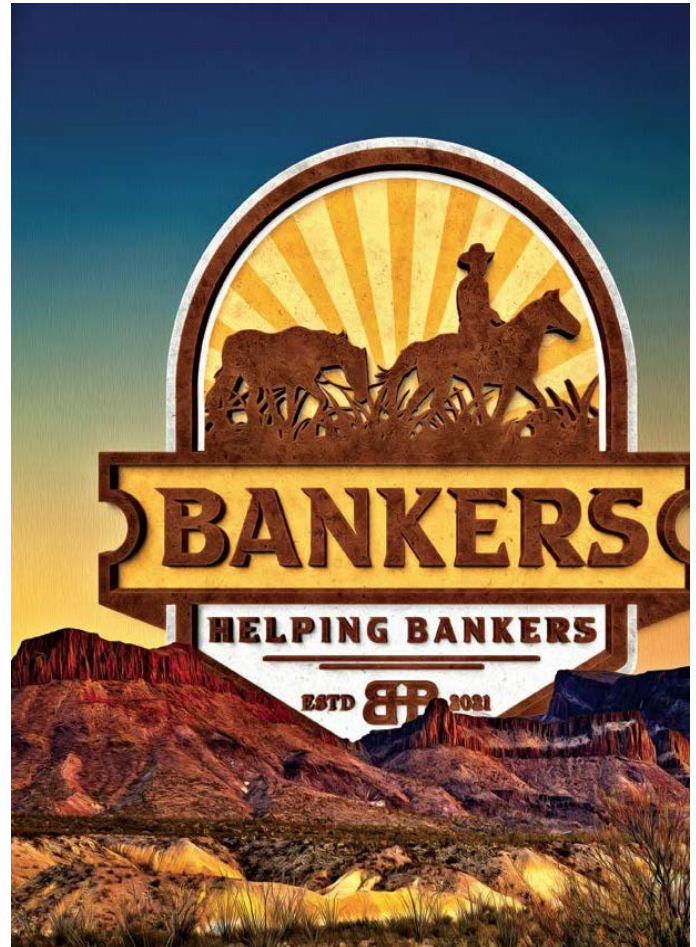


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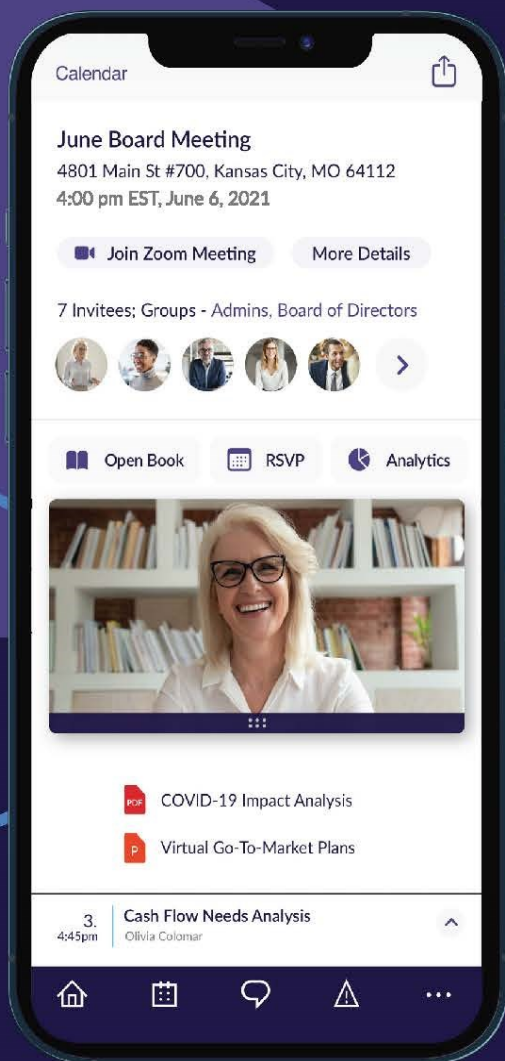
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Unleashing the Power of AI in Banking: Empowering Bankers and Enhancing Customer Experience

BY THOMAS DOUGLAS

In the ever-evolving world of banking, a remarkable transformation is taking place, driven by the advancements in Artificial Intelligence (AI). AI is not just a buzzword; it's a game-changer that holds immense potential to revolutionize the way banks operate.

In this article, we will delve into the incredible benefits of AI in banking, focusing on how it can empower bankers, streamline compliance processes, and ultimately provide customers with a more personalized and exceptional experience.

Empowering Bankers for Efficiency

AI has the remarkable ability to automate mundane and repetitive tasks that once consumed a significant portion of bankers' time. Imagine having more hours to focus on building solid relationships with clients, understanding their unique financial needs, and delivering tailored solutions.

By harnessing the power of Natural Language Processing (NLP), AI algorithms can analyze vast amounts of customer data, extract valuable insights, and generate personalized recommendations. This empowers bankers to provide targeted advice, craft customized financial plans, and offer tailor-made solutions that genuinely resonate with their clients. With AI at their side, bankers can unlock their true potential and become trusted advisors who can deliver exceptional value and guidance.

Furthermore, AI algorithms can expedite credit scoring and loan underwriting processes, significantly reducing the time taken for these operations. By utilizing machine learning techniques, banks can analyze historical data to assess creditworthiness with utmost accuracy. Faster loan approvals not only enhance operational efficiency but also enable bankers to serve more clients, opening doors for financial growth and expansion.

Streamlining Compliance Processes

Compliance is a critical aspect of the banking industry, and maintaining adherence to regulatory standards can be complex and time-consuming. This is where AI steps in as a reliable ally.

AI-powered solutions can automate compliance processes, alleviating the burden of manual tasks and minimizing the risk of errors. These intelligent algorithms continuously monitor real-time transactions, swiftly flagging suspicious activities and potential fraud attempts. By leveraging machine learning, banks can stay one step ahead of fraudsters, adapting to evolving techniques and safeguarding their customers' financial well-being.

Moreover, AI-driven virtual assistants and chatbots can assist customers with inquiries related to regulations, privacy policies, and account details. These intelligent assistants provide accurate and consistent responses, ensuring compliance across all customer

interactions and freeing up valuable time for compliance officers to focus on more complex cases. With AI handling routine compliance tasks, banks can breathe a sigh of relief and allocate their resources more strategically.

Personalized Service that Puts Customers First

AI can transform the customer experience by enabling bankers to provide highly personalized services that cater to individual needs and aspirations. With comprehensive customer profiles and real-time insights, bankers can gain a profound understanding of their clients' financial goals, preferences, and challenges.

By leveraging AI algorithms, bankers can identify cross-selling and upselling opportunities, offering tailored product recommendations and customized financial solutions. The result is an enhanced customer experience demonstrating a deep understanding of their financial journey.

AI-powered virtual assistants and chatbots are vital when ensuring round-the-clock availability and prompt customer support.

These intelligent bots handle simple inquiries and routine transactions, providing instant assistance and reducing wait times. Customers appreciate the convenience and efficiency of interacting with AI-driven interfaces, knowing that their needs are met promptly and effectively.

Looking Forward

The power of AI in banking is undeniable. By harnessing this technology, banks can empower their bankers, streamline compliance processes, and deliver unparalleled customer experiences. With AI automating mundane tasks, bankers can focus on building lasting relationships and providing personalized financial advice. Compliance processes become more efficient, thanks to AI's ability to monitor and adapt to ever-evolving fraud techniques.

As AI continues to evolve, striking the right balance between automation and human interaction remains crucial. Banks that embrace AI-driven solutions are poised to adapt to changing customer expectations, enhance operational efficiency, and gain a competitive edge in the dynamic banking landscape. AI is shaping the future of banking, and it's an exciting journey that promises to transform the industry for the better.

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Tom Douglas is Chief Executive Officer at JMark Business Solutions, an ACB Associate Member. He can be reached at 844-44-JMARK

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UCC amended to accommodate digital commerce

BY DAVID A. GARDNER

The Uniform Law Commission and American Law Institute amended the Uniform Commercial Code (UCC) in 2022 to accommodate digital asset transfers and recognize the increasing use of digital commerce. The key amendment is Article 12, which

establishes rules for Controllable Electronic Records (CERs) concerning obtaining control and take-free provisions for qualified purchasers. Article 9 has been amended to include new rules for the perfection and priority of CERs. CERs are a specific type of digital asset under Article 12's control rules. The law for electronic records before the Amendments, such as deposit accounts like checking accounts and electronic versions of chattel paper or documents of title, remains unchanged. The Amendments aim to create technologically neutral language in the UCC, ensuring its longevity and enabling consumers to use their digital asset portfolios in commercial transactions.

Control is a crucial concept in transforming a generic digital asset into a CER. It involves four elements: Benefit, Exclude, Transfer, and Identify. Control means the possessor can enjoy the benefits of the CER while preventing others from doing the same, all while retaining the exclusive power to transfer it. Identification can be demonstrated in numerous ways, such as providing proof of power through accessing an online account using a username and password or presenting the CER's physical storage device like a memory card, to establish Article 12 control over the asset.

Perfection and priority rules have been amended to address the unique challenges of digital asset transfers. Digital assets are classified as general intangibles under UCC Article 9, which previously required filing for perfection. However, the Amendments favor perfection by control for CERs, recognizing their distinctive nature. Parties perfected by control now have priority over parties perfected by filing, even if the filing occurred first.

The UCC includes take-free provisions to facilitate commerce, ensuring buyers can acquire goods, and now CERs, without the risk of it being taken back. Article 12 extends this principle further, stating that any qualified purchaser of a CER takes it free and clear of any outstanding security interest. However, the purchaser must meet certain criteria, such as obtaining the CER for value, in good faith, and without actual notice of any claims to the CER.

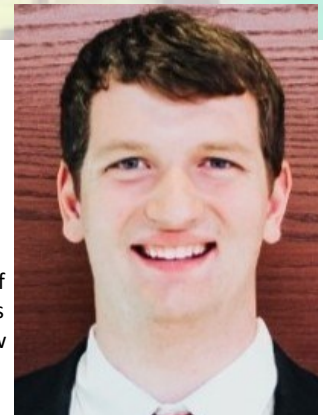
Tethering refers to the rights conferred by possessing or owning another separate record. For example, a negotiable promissory note documenting the right to be paid by the maker of the note is merged into, or tethered, to the writing. The general rule in the Amendments is that an electronic record does not give rights to property associated with the record. However, there are exceptions for Electronic Controllable Accounts and Electronic Payment Intangibles. For example,

electronic chattel paper. These rules provide clarity for lenders, assuring lenders that digital or online lending documents will not impede their rights under the UCC.

The amendments signal two significant takeaways for lenders. Firstly, the rise of digital assets in commercial transactions has led to the creation of specialized law and lenders can now use digital assets, such as social media accounts or electronic records, as collateral. Secondly, lenders should prioritize obtaining legal possession of any digital assets used as collateral. Parties perfected by control have super-priority, and securing login credentials or transferring ownership of the assets better protects lenders.

A hypothetical example is provided to understand how the Amendments operate in practice. It involves a collegiate athlete who wants to use her social media accounts as collateral for a loan. The lender requires proof of ownership and possession of the login credentials to her social media accounts, allowing the lender to control the social media accounts. This control enables the lender to benefit from, exclude others from, transfer, and identify the lender as the owner of the accounts. This satisfies the Article 12 control requirements. By establishing Article 12 control over the CER, the lender's interest is perfected with super-priority over other claims to the social media accounts.

In conclusion, the UCC Amendments of 2022 address the challenges of digital assets in commerce. Lenders now have opportunities to use digital assets as collateral, and controlling these assets is vital for their protection. These Amendments create rules for the control, perfection, and take-free provisions for digital assets, ensuring the UCC remains relevant in the digital age of commerce.



David Gardner is an Intern at Quattlebaum Grooms Tull, PLLC and a student at the UALR William H. Bowen School of Law. QG&T is an ACB Preferred Services Provider.

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* Home Study Problem ** Case Study

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* Home Study Problem

** Case Study

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The Thriving HSA Opportunity for Banks

And How to Stay Ahead of the Competition



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Like any financial account, simply providing access to HSAs is not enough. Modern HSA providers, such as Lively, pair proprietary technology with user-centric design, all backed by dedicated support and personalized education. The result is significantly higher engagement and contributions compared to the rest of the industry.

\$5,704 AVERAGE LIVELY HSA ACCOUNT BALANCE IS MORE THAN DOUBLE THE INDUSTRY AVERAGE

57% LIVELY HSA 2020 CONTRIBUTIONS WERE CARRIED INTO 2021, COMPARED TO 28% INDUSTRY AVERAGE

+37% LIVELY ACCOUNT HOLDERS CONTRIBUTE MORE TO THEIR HSAs THAN THE INDUSTRY AVERAGE

73 AVERAGE LIVELY NPS INDICATES HIGH LEVEL OF ACCOUNT HOLDER SATISFACTION WITH THEIR HSAs

Find out how Lively's turnkey HSA solutions can enhance your bank's offerings.

Sources: [1] Devenir Research. "2020 Year-End HSA Market Statistics & Trends." March 2021. [2] Devenir Research. "2020 Devenir & HSA Council Demographic Survey." June 2021.



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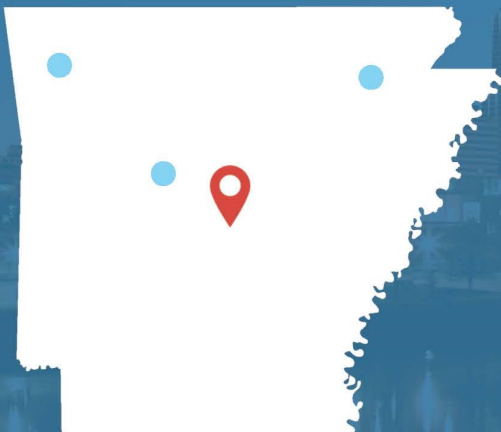
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