

# ARKANSAS A COMMUNITY BANKER

Winter 2023

THE VOICE FOR ARKANSAS' COMMUNITY BANKS



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What is "Quite Hiring"? - page 34

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# A view from the Capitol

BY CHRIS PADGETT

**2023** kicks off with the start of the 94<sup>th</sup> Arkansas Legislative Session. Always enlightening to pay such close attention to the legislation brought before our representatives. Though I've learned we could probably get by with about 75% less legislation. And luckily, for community banks, we don't have much to worry about from our State legislative sessions. They are mostly accommodating to our needs and opinions. But that doesn't mean we don't get some odd-ball bills that show up from time to time.

Currently, Senate Bill 41, for all intents and purposes, dictates who a bank can and cannot do business with – if you want to hold state funds anyway. The Bill states: *The Treasurer of State shall divest the state of stocks, securities, or other obligations if a financial services provider or an investment manager discriminates without a reasonable business purpose against certain businesses involved in the energy, fossil fuel, firearms, or ammunition industries or investments based on the use of environmental, social justice, or other governance-related factors.* Similarly, bills like this have been popping up in other State Houses around the country, word for word. Which is almost always a red flag.

SB 41 speaks to a bank “discriminating” against these few businesses. But would the State also not be discriminating against a bank that chose not to do business with one of these entities? What if a bank refused to do business with a gas company that had previous violations of environmental damage? Would a bank be wrong to include these “environmental” factors as part of their risk assessment in determining whether to provide funding? What if the bank thought this company, based on their past environmental disparities, was at increased risk of being sued for future violations, and hence the bank made the decision to not fund a loan, even though this energy company's proforma cashed out?

But then you read the definitions of “reasonable business purpose” (the reasons a bank may deny these select businesses

services) and they are: (A) *Promoting the financial success or stability of a financial services provider;* (B) *Mitigating risk to a financial services provider;* (C) *Complying with legal or regulatory requirements;* or (D) *Limiting liability of a financial services provider.*

When choosing to offer a service or to provide funding to any business, these are literally the requirements a bank uses to mitigate the bank's risk. It's what a bank does. It mitigates risk - on a number of factors.

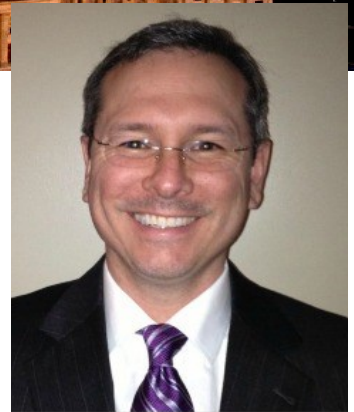
So, if a bank can't deny an energy, fossil fuel, firearms, or ammunitions company based on ESG factors, as the bill states, but the reasons a bank can use to deny these companies can be ESG “related”, then what's the point? This Bill reminds me of the “Sharia Law” bill from 2017. Now known as Act 980. Which declares *American Laws for American Courts*. As one leading voice and supporter of the law stated, “[this law] doesn't do a whole lot and I hope it would actually never do anything.” I think that about sums up SB41.

Now, I know where this grievance bill originates. Federal regulators pushing the largest banking institutions (\$100 Billion and over) to be more prudent in their lending requirements based on questionable ESG metrics. Or pressing small businesses to craft policies concerning their environmental impact or how reliant on certain resources they might be. ACB stands against these requirements, knowing all too well “stuff” always rolls downhill. But this bill offered up really does nothing but cause confusion and creates more opportunity for egregious litigation (I can see the commercial now: Are you an energy, firearms, or ammunition maker in AR and have been denied funding? Call me today to make these banks pay for their discriminatory practices. We guarantee the largest payouts...) against our members. It's just not well thought out policy, and I don't believe the State should dictate to banks who they can and cannot do business with, notwithstanding the other businesses that are not included in this bill that might like to be included against “discrimination”. This bill is fraught with unintended consequences and is way too ambiguous.

The good news, as a great representative once said, if this bill passes it won't do a whole lot.

Thank you for supporting ACB and we look forward to a great 2023. This is your association, should you ever need anything, please do not hesitate to reach out.

Good banking.



Chris Padgett is the ACB Executive Director. You may connect with Chris at 501-246-4975 or [chris@arcommunitybankers.com](mailto:chris@arcommunitybankers.com)



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Winter 2023

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- Fiduciary liability (ERISA)

#### Crime

- Financial institution bond
- Kidnap and ransom

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- 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

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# Navigating the Potential Impact of Recent Regulatory Guidance

BY GALE SIMON-POOLE



**A**s we enter 2023, our industry is faced with unprecedented risk management challenges amid rapid technological and competitive changes. Federal and state authorities have recently issued guidance to address paradigm-altering shifts such as climate change, artificial intelligence (A.I.), cryptocurrency, digital and mobile banking, credit models, data security, and more. Financial institutions should understand how these changes could affect their operating model and strategy.

Below are highlights of recent select regulatory guidance. Learn how they might affect community banks in the near term and discover the steps banks can take to successfully prepare themselves for a shifting compliance backdrop.

## Climate Risk

- Impacts large financial institutions first; the Federal Reserve Board will conduct a pilot to analyze climate-related financial risk involving the six largest U.S. banks in early 2023.

## Modernize the Community Reinvestment Act

- Mainly affecting retail lenders, changes to the CRA would – among many other things – increase access to credit, investment, and basic banking services in areas where it is needed most; generally, in low- and moderate-income communities.

## Small Business Lending Data Collection

- Will impact most U.S. financial institutions when implemented in 2023. Requires lenders to annually report small business credit application data, including credit purpose, loan amount, business info and location, gross annual revenue, NAICS code, and more.

## Expansion of [UDAAP](#) Standards

- Broadens the scope of consumer activities subject to UDAAP beyond lending to include advertising, pricing, servicing, reporting, payments, and collections. However, a lawsuit by several banking trade associations seeks to prevent the expansion of CFPB's UDAAP role beyond its Dodd-Frank Act statutory authority.

## Reporting Credit Decisions that Use Complex Models/Algorithms

- Lenders using A.I., machine learning, and/or complex credit models must disclose the precise reason(s) for credit denials as required by the Equal Credit Opportunity Act. Adverse action notices must also

be timely and provide accurate reasons for denial, as mandated by current requirements.

## Enhanced Consumer Privacy Laws

- Five states have already enacted enhanced regulations: CA is already in effect; CO, CT, CA, and UT state requirements become effective in 2023. Six other states (MA, MI, NJ, NC, OH, PA) have active legislation pending.

## Oversight of Bank Third-Party Risk Management (TPRM)

- Vendor/third-party relationships are generating renewed regulatory scrutiny, especially fintech partnerships. Ineffective TPRM could be cited as unsafe or unsound practice. Banks must demonstrate TPRM through documentation of third-party relationships, conduct audit and performance reviews, and require third parties to provide data that confirms the quality and sustainability of controls to meet service agreements.

## What's an appropriate change management strategy for community banks?

Each regulatory scenario described above warrants a course of action specific to that issue. For example, regarding the enhanced consumer privacy laws, banks should revisit privacy disclosures, notices, and policies within the states they operate.

On a broader scale, it would be prudent for banks to utilize the strategies below to successfully manage the collective number of impending regulatory changes following these three steps.

### 1. Stay informed of changes through industry groups and trade associations

Seek clarification and/or assistance from trusted partners outside of your organization. In addition, involve your operations, technology, and compliance staff to gain a comprehensive view of any potential changes. It is also prudent to communicate with your Board and senior staff and to document your regulatory discussions in Board minutes.

### 2. Designate an internal stakeholder to implement/monitor regulatory changes

In addition to participating in the activities discussed above, this individual can conduct testing after implementation to ensure the process and related controls are operated as intended. It is imperative for this stakeholder to document your bank's change management efforts for subsequent review by external parties.



*Gale Simon-Poole is Chief Regulatory Relations Officer at BHG Financial. BHG is an ACB Associate Member.*

### 3. Partner with an external regulatory expert

Given the scope of impending legislation, banks may want to simply outsource their regulatory practice to an external provider. Staying current with newly implemented and/or potential regulations requires time, expertise, and deep industry knowledge. An external overseer can advise on necessary regulation and compliance issues, giving banks the freedom to focus on serving their communities. In addition, hiring an external partner may be a cost-effective solution for smaller banks that do not have the resources to maintain or support a compliance function.

#### Key Takeaways

- Banks large and small will face a plethora of issues on the regulatory agenda in the new year ahead.
- Topics as complex as artificial intelligence and as broad as global climate change are just two of the many regulatory focus areas that banks must contend with.
- To stay compliant amid impending legislative shifts, banks may wish to partner with an external regulatory expert for guidance and support.

[For more information about compliance and regulatory solutions](#)



For more information about BHG contact Courtney Calderwood, SVP, Institutional Relationships. She may be reached at 315-277-6598 or [ccalderwood@bhgbanks.com](mailto:ccalderwood@bhgbanks.com)



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# Fair Lending Risk Factors Updated

BY MICHAEL WALLACE

**O**n January 12, 2023, the OCC released an update to its *Fair Lending Handbook (FLH)* for the first time since 2010. The new *FLH* reflects changes to laws and regulations and describes the current OCC approach to fair lending examinations. Notably, the *FLH* clarified and expanded fair lending “risk factors” that are associated with the *Interagency Fair Lending Examination Procedures (IFLEP)*. Examiners from all federal regulatory agencies use fair lending risk factors to determine the scope and depth of examinations and other targeted supervisory events.

Regardless of your prudential regulator, it is important to understand the revised risk factors for applicability to your institution. *IFLEP* has not been updated since August 2009, but the *FLH* revisions signal that *IFLEP* changes are on the horizon. The *FLH* now provides the most comprehensive list of fair lending risk factors. The changes to *FLH* risk factors fall into three primary categories: (1) those that align with the *Uniform Interagency Consumer Compliance Rating System (CC Rating System)*, (2) those that extend risk factors that “may implicate fair lending laws,” and (3) those that add other real estate owned (OREO) practices.

**First**, the risk factors were amended to better align with guidance provided within the *CC Rating System*. The *CC Rating System* has been in place with examinations commencing on or after March 31, 2017. The *CC Rating System* provides the numerical rating scale for compliance examinations, and it also establishes the “pillars” of a compliance management system. For example, the revised *FLH* risk factor C5 focuses on an overall compliance management system, rather than a compliance program, in concert with the *CC Rating System*. It is notable that this update now references two of the

primary pillars of a compliance management system: (1) board and management oversight and (2) compliance program.

**Second**, the risk factors were amended to incorporate “abusive (or predatory) lending practices that may also implicate violations of fair lending laws.” This is a significant addition relative to the current version of *IFLEP*, and it seems to align with the changes to the *UDAAP Examination Procedures* published by the CFPB in March 2022. The risk factors include

weak compliance management associated with unfair, deceptive, or abusive acts or practices; Regulation Z; and Regulation X. The risk factors also include failure to adopt and implement comprehensive oversight related to the use of third parties.

**Third**, the risk factors were expanded to include practices related to OREO. These OREO risk factors are the newest addition to the OCC’s *FLH* and were likely brought about in response to numerous complaints and lawsuits associated with the treatment of OREO located in areas with concentrations of minority residents (minority areas). The four new risk factors include (1) variations in OREO policies, procedures, or management that are correlated with minority areas; (2) training deficiencies for staff or third parties assigned to OREO functions; (3) complaints related to OREO in minority areas; and (4) information indicating unequal maintenance, marketing, or disposition of OREO. It is also important to note that the OCC’s *FLH* contains risk factors for two additional aspects of credit operations that are not in the current version of *IFLEP*: (1) Loan Servicing and Loss Mitigation and (2) HELOC Modifications. Unlike the OREO risk factors, those two additional aspects of credit operations were in place within the *FLH* prior to the January 2023 changes. Collectively, none of these three aspects of credit operations (e.g., OREO, Servicing/Loss Mitigation, HELOC Modifications) that appear within the revised *FLH* are found in the current version of *IFLEP*.

At this time, the OCC’s *FLH* provides the most comprehensive list of fair lending risk factors. It expands well beyond the risk factors listed in the current version of *IFLEP*. In conducting your fair lending risk assessments, we recommend use of the risk factors found in the OCC’s *FLH*, irrespective of your prudential regulator. While *IFLEP* is anticipated to be updated in the near future, you can act now to understand the OCC’s revised fair lending risk factors and incorporate them into your fair lending compliance management system.

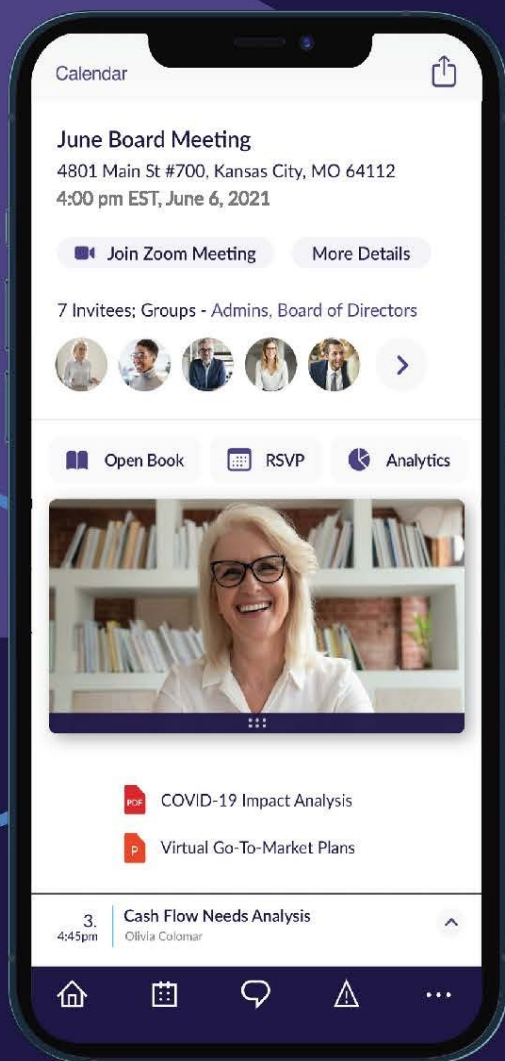


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# Time to lock in?

SBICs can hit the sweet spot on the yield curve.

BY JIM REBER

**A**fter several years of trying (mostly futilely) to normalize cash flows from a community bank's collection of investments, portfolio managers may once again have to address a shift in the direction of interest rates in 2023.

Volatility since the pandemic created extremes in the amounts of liquidity being thrown off by bond portfolios. The years of 2020–21 saw wave after wave of prepayments and calls as market rates (and mortgage rates) plummeted to generational lows. Last year, with its 300+ basis point rate shock, the opposite was true: Cash flows completely dried up, and quickly.

So now, as portfolio managers look at nominal interest rates and wonder if we're most of the way to the end of this rate cycle, some are trying to find value in the belly of the curve, which for our purposes is roughly three to seven years. At some point, the curve will no longer be inverted, and it's probably going to be due to shorter rates falling. At the same time, most community banks are still exposed to a decline in rates.

The Small Business Administration (SBA) has a number of products that may be suitable for community banks, the most visible of which are 7 (a) pools, floating rate securities that adjust based on Prime. It also has fixed rate pools known as Small Business Investment Companies (SBICs) that have fixed rates and reasonably short stated final maturities. These SBICs seem to offer relative value for fixed-rate investors, so let's dig in to see how they work.

### Things you'll like

For starters, I'll point out the obvious: SBA products are full faith and credit instruments, and therefore 0% risk weighted. Another feature is that the fixed rate pools come in 10-year stated final maturities, which fit most community banks' interest rate risk profiles. Their liquidity is

good, but probably not quite to the level of residential mortgage-backed securities (MBS).

SBIC pools are collateralized by debentures issued by small business investment company funds, which are licensed and regulated by the SBA. There are 299 such funds currently operating, and the SBA guaranteed \$11.9 billion of the outstanding debentures as of June 30, 2022. (For context, the MBS market is about \$12 trillion.) The SBA issues a 10-year pool every March and September, and the coupon is set shortly before issuance to be priced near par. Something unique about SBICs is that principal does not amortize; they pay only semi-annual interest until the stated maturity date. However, here's another feature that makes SBICs attractive to community banks: The individual debentures can prepay, so that the cash flows, average lives and durations are all considerably shorter than a 10-year agency.

### Why now?

Investors may see value for several reasons. First, if a given community bank is trying to lock in today's yields, SBICs tie the money down for a desirable period of time. Their average lives will be around six years at the outset, although there will be very little principal returned initially, which may be a bonus. Also, the 10-year final looks good to portfolio managers. The new pools will have relatively current coupons, so their prices will be at or around par, and the benefit is an on-market interest payment initially.

The most recent 10-year SBIC pool is 2022-10B, issued in September 2022. It is backed by 456 debentures totaling \$1.2 billion, guaranteed by the SBA. The pool has a stated rate of 4.262%; its market price will fluctuate like any other bond, although recently it has been available at a small discount. While the debentures can prepay, they don't exhibit the same type of rate sensitivity that residential MBS do. Remember that the principal will be back-loaded, so it's likely that your original investment will change very little for several years. And that's another possible advantage of an SBIC pool in this rate environment: the deferral of principal repayments, while still offering a final maturity that's smart for many community banks. Even better is that currently the yield spreads offered by SBICs compare very favorably to alternatives, such as straight agencies, 10-year MBS and even taxable municipal bonds.

To recap, Small Business Investment Company pools check a lot of boxes for portfolio managers. Great credit quality, sufficient liquidity and average maturities that sync with most community banks' risk profiles to name a few. And, diversification into a new investment sector is never a bad idea.



*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](mailto:jreber@icbasecurities.com).*

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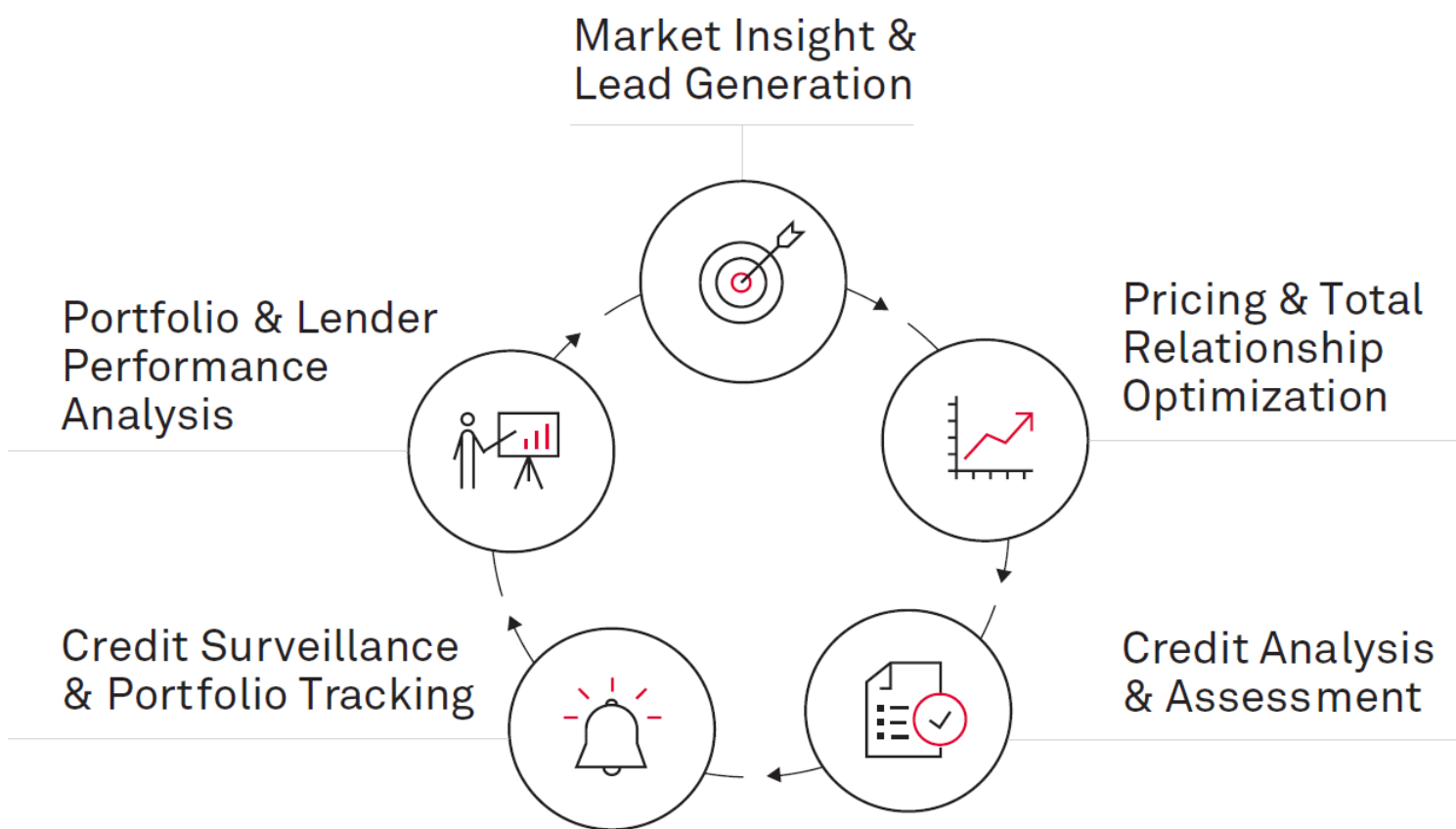
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# Rising Interest Rates Complicate Banks' Investment Portfolios

BY CARL WHITE

**R**ising interest rates have prompted both challenges and opportunities for banks over the past year. Bank supervisors are, understandably, urging bankers to pay close attention to a myriad of ways changing interest rates can affect earnings and capital, or what's termed interest rate risk.

While rising interest rates give banks opportunities to increase earnings by pushing up rates charged on loans, they also could increase the cost of liabilities and decrease the value of investment securities held as assets. Even unrealized losses—paper losses—in investment portfolios can have negative effects on liquidity and present funding challenges, earnings pressures and, in some cases, issues with capital.

## Interest Rates and Bond Prices

The inverse relationship between bond prices and interest rates means the sharp increases in interest rates this year have lowered the value of fixed-rate bonds held as investments, including those of banks. Many banks increased their holdings of bonds during the pandemic, when deposits were plentiful but [loan demand and yields were weak](#). For many banks, these unrealized losses will stay on paper. But others may face actual losses if they have to sell securities for liquidity or other reasons.

Other possible consequences of significant unrealized losses include reductions in or restrictions on borrowing capacity and declining market valuations of the affected institutions, which could have a negative impact on banks looking to engage in merger and acquisition activities.

Just prior to the pandemic, roughly 20% of bank assets consisted of investment securities—primarily mortgage-backed securities and U.S. Treasury securities. By the end of 2021, security holdings had increased to 25% of assets, with most of the growth occurring in U.S. Treasury securities. Many of those purchases were for securities with longer maturities, which drop in value more than short-term securities when interest rates rise.

## Effects on Capital and Liquidity

Losses on investment securities—realized or not—can affect a bank's capital position. In general, banks must classify their securities into two buckets: held for maturity (HTM) and available for sale (AFS).<sup>1</sup> The difference between the amortized cost of AFS securities and their current fair value is recorded in a category called accumulated other comprehensive income (AOCI), which is subtracted from equity capital on a bank's balance sheet. While AOCI is excluded in measures of regulatory capital for community banks, it does affect what's known as tangible common equity (TCE).<sup>2</sup>

TCE is declining industrywide because of the negative effect of rising rates on the market value of bank holdings of AFS securities. The

number of banks with ratios of TCE to average tangible assets of less than 5% jumped markedly in 2022, with some banks posting negative TCE. Banks in this position largely got there because of an aggressive earnings strategy based on longer-term securities holdings when interest rates were low.

Banks with very low or negative TCE may face funding challenges. Federal Home Loan Banks (FHLBs), for example, are not permitted to extend new loans (called advances) to banks with negative TCE, and existing FHLB loans may not be renewed beyond 30 days unless waivers are obtained by borrowers' primary regulators.<sup>3</sup> That could be problematic for banks facing a runoff in deposits or other liquidity concerns; in a worse-case scenario, a bank might have to sell "underwater" bonds to raise cash, thus realizing losses and reducing regulatory capital.

## The Supervisory Perspective

Large unrealized losses in the investment portfolio increase a bank's risk profile, but the extent varies by bank. Supervisors are less likely to be concerned if the duration<sup>4</sup> or maturity of a bank's assets (loans and investments) and liabilities (deposits and other borrowings) are roughly the same. Concern would be further reduced if assets were funded by stable, non-maturity deposits, such as checking and savings accounts.

To reduce risks to liquidity, capital and earnings from unrealized losses, banks can take several steps, including diversifying contingent funding sources, especially if reliant on FHLB advances. The Federal Reserve's discount window is one option. Increasing the ratio of HTM to AFS securities through new purchases or reclassification may ameliorate declining or low TCE at some institutions, although reclassification does not eliminate the risks associated with owning fixed-income securities in a rising rate environment.

In general, a bank should carefully analyze its existing capital and liquidity planning for possible adjustments based on current positions as well as the likelihood of further stress.

*This article is part of a series titled "Supervising Our Nation's Financial Institutions."*

## Notes

1. Some banks (mostly very large banks) hold securities in trading accounts, and those securities are classified separately. Changes in the fair market value of these holdings flow through the income statement and are counted as current income or expense.
2. Tangible common equity is calculated as equity capital less goodwill, other intangibles and disallowed mortgage servicing rights.
3. See this *American Banker* article for more on [the FHLB rule](#).
4. The change in the valuation of an asset or liability that may occur given a discrete change in interest rates.

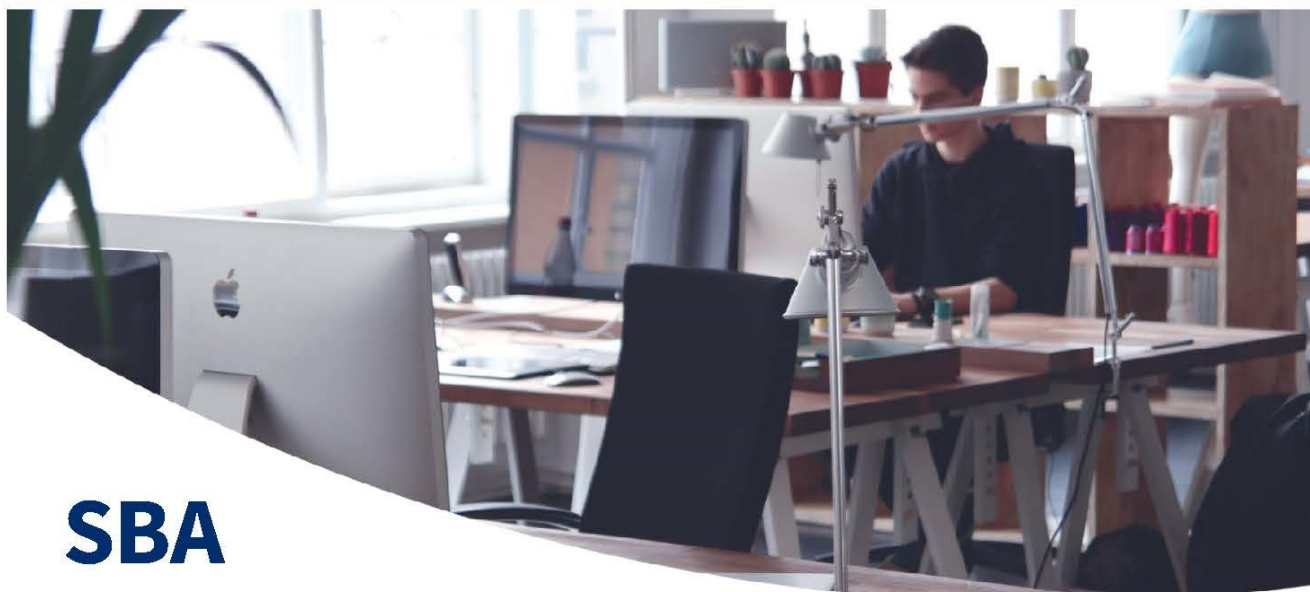


*Carl White is SVP of the Supervision, Credit and Learning Division at the Federal Reserve Bank in St. Louis. You may connect with Carl at [Carl.White@stls.frb.org](mailto:Carl.White@stls.frb.org)*





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# Pros and Cons of Community Banks Using Artificial Intelligence

An ACB Experiment

BY ChatGPT

The use of artificial intelligence by financial institutions, particularly community banks, has been a subject of debate for quite some time. During this time the AI industry has evolved exponentially into an amazing and sometimes frightening phenomenon. ACB has watched this evolution with keen interest. In an attempt to satisfy our curiosity we came up with an idea for an experiment. We accessed the website of one of the more robust AI platforms that offers a service which answers questions in the format of a white paper article. We entered a simple question: *In 1,000 words, what are the pros and cons of community banks using artificial intelligence?* The following is the automated response written entirely by ChatGPT, which is the result of our experiment and became the basis for this article. We believe you will be as amazed and we are.

The use of AI technology by community banks has become a hot topic in the financial industry in recent years. While AI has the potential to transform the way community banks operate and serve customers, it also presents a number of challenges and risks that must be carefully considered. In this article, we will explore the pros and cons of using AI technology in community banks.

## Pros:

1. **Improved Efficiency and Accuracy:** One of the biggest advantages of AI technology is its ability to automate routine tasks, such as data entry and customer service inquiries. By freeing up staff to focus on more complex tasks, AI can improve the efficiency and accuracy of community banks, providing faster and more accurate responses to customer questions and reducing the risk of errors.
2. **Better Risk Management:** Another major benefit of AI technology is its ability to help community banks analyze large amounts of data to identify and mitigate financial risks, such as loan defaults and fraud. AI algorithms can quickly analyze large amounts of data and identify patterns and anomalies that may indicate a potential risk. By proactively identifying and mitigating these risks, community banks can protect their customers and their own financial stability.
3. **Enhanced Customer Experience:** AI can be used to personalize customer interactions and offer tailored financial products and services, improving the overall customer experience. By using machine learning algorithms to analyze customer data, community banks can gain a deeper understanding of their customers' needs and

preferences, and offer them customized products and services that meet their specific needs.

4. **Competitive Advantage:** By embracing AI technology, community banks can stay competitive with larger banks and financial institutions that are also investing in AI. By improving the efficiency and accuracy of their operations and enhancing the customer experience, community banks can attract and retain more customers, and increase their market share.

## Cons:

1. **Cost of Implementation:** One of the biggest challenges of using AI technology in community banks is the cost of implementation. AI systems can be expensive to develop and maintain, and the costs of training staff to use these systems can also be significant. For community banks with limited resources, the costs of implementing AI technology can be prohibitive.
2. **Lack of Trust and Understanding:** Another major challenge of using AI technology in community banks is the lack of trust and understanding among customers. Some customers may be hesitant to use AI technology, particularly if they are not familiar with it or have concerns about privacy and security. Community banks must take steps to educate their customers about the benefits of AI and ensure that their data is protected.
3. **Job Displacement:** The automation of routine tasks may result in job loss for some employees, creating potential social and economic impacts for local communities. Community banks must consider the potential impact of AI on their employees and work to minimize job losses where possible.
4. **Dependence on Technology:** Overreliance on AI technology can leave community banks vulnerable to failures or security breaches, particularly if the technology is not well-maintained or properly secured. Community banks must ensure that their AI systems are properly maintained and secured, and have contingency plans in place in case of a failure or breach.

In conclusion, the use of AI technology by community banks presents both opportunities and challenges. Community banks must carefully consider the costs and benefits of AI, and develop strategies for maximizing its value while mitigating its risks. This may involve investing in training and education for employees, working with technology partners to ensure the security and reliability of AI systems, and engaging customers to build trust and understanding of AI technology.

By carefully balancing the pros and cons of AI technology, community banks can harness its power to transform the way they serve customers and grow their businesses. With the right approach and commitment, community banks can use AI to improve their operations, increase their competitiveness, and provide better financial services.

As said earlier, the article above was written entirely by ChatGPT, in only 47 seconds. Imagine the possibilities.



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Eundra Boles

Eundra Boles is the Vice President of Information Technology Services of Celerit Solutions Corporation. Eundra has over twenty-five years of expertise in keeping financial infrastructures up-to-date, safe and secure. He leads a team of seasoned technicians, providing around-the-clock protection to keep your network safe from the new and sophisticated cyber-threats faced today, while looking to the future for the next surfacing risk.



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*“As we enter a new chapter and start a new financial statement cycle, know that ICBA will be there to support you with tools, resources, and advocacy efforts.”*

The beginning of a new year feels like a fresh start, a new chapter in our stories. We have a blank page on which we can write our narrative over the course of the year, with new milestones filling the pages ahead. And with 2023, we have no shortage of adventures awaiting us.

Consider industry evolution. I’m amazed at the pace of change occurring in all areas of financial services, from instant payments to more digital solutions and beyond. This will be a pivotal year for embracing new opportunities and exploring how we can set ourselves up to succeed, even with looming challenges.

And think about the uncertainty of the economic environment. It’s a challenge to be sure, but it’s one that community banks have previously faced with strength. Time and time again, you have demonstrated resiliency in the face of difficult financial conditions. In fact, this is when community banks shine, bringing stability to customers simply by being relationship bankers who see them and know them. Looking at it through a different lens, there’s opportunity in this economic climate: It’s a way to double down on your strengths and unique people-first approach to banking.

Yet, amid these external influences, you may be asking, “What actions can we take to ensure we’re identifying the right next

step for our bank?” That’s where ICBA can provide support. Whether it’s the information that comes in *NewsWatch Today* or *Independent Banker*, convening with other community bankers to discuss strategies at ICBA LIVE or proactive engagement with lawmakers at the Capital Summit, we offer opportunities to not just react but respond to this dynamic environment with your mission and vision at the center.

We have increased our offerings to support you and to further differentiate our industry. For example, we have moved the ThinkTECH Accelerator in-house to ensure year-round innovation programming and find new fintech partners who are bringing to market solutions that respond directly to community bank needs. We’re expanding classes and programs provided by Community Banker University, and as the government relations team prepares to welcome new members of Congress to D.C., they are ready and excited to tell your story and ensure your voices are heard.

So, as we enter a new chapter and start a new financial statement cycle, know that ICBA will be there to support you with tools, resources, and advocacy efforts. Together, we will write our 2023 story, one that will set community banks up for success.



## Where I’ll be this month

I’ll be holding down the fort at ICBA headquarters, helping our government relations team as we welcome new members of Congress and gearing up for ICBA LIVE .

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# A Common Board Refrain: Because We've Always Done it that Way!

BY PHILIP K. SMITH

The beginning of a new year presents an opportunity to make resolutions and try new things. This new beginning also offers the opportunity for forward looking strategic planning if for no other reason than to get out of the rut the Bank may be in. While the new year may present some of the same challenges your organization currently faces, we believe many organizations may find themselves in uncharted territory or at least in areas that have not been seen for a number of years (enforcement actions, asset quality problems?). As you map out your expectations, be honest about your organization and avoid the common refrain that your existing plans, processes, and procedures have to continue to be the same *"because we've always done it that way"*.

That phrase, alone, may be the number one impediment to progress in an organization. If anyone ever questions why particular events happen, why a process is managed the way it is, why decisions unfold in a certain way, or a thousand other items within your organization, are those questions viewed as strategic opportunities or are they viewed negatively? In community banking, the failure to change may be even more prevalent than in other organizations. We tend to find something that has worked for years and we continue to follow that model because, in fact, it has been successful. For 2023, however, at least consider whether different circumstances should produce different strategies.

Our challenge to organizations in the current environment is to critique yourself and to assess what you are doing and ask if the manner in which you are doing it can realistically continue to be successful in the future. For example, can a Board of Directors continue to act efficiently

without having online Board portals for the review of information? Can a financial institution, even in the most remote or rural area, continue to operate without appropriate levels of technology (maybe, but for how long?)? Can your entire organization continue functioning with reporting lines of authority throughout the organization that no longer make any sense or consolidates too much time or power in one person? Should the number and locations of branches remain the same? Should we implement new processes to better attract and retain the best employees? Is this the year we finally decided to acquire another institution or pursue a sale? The idea is not to totally change what you are doing just for the sake of change, but to at least question why you are doing things a certain way. If, after considering and analyzing, you determine that the current approach is still the best, then great, stick with what works.

We have seen similar dialogue unfold over the past twelve months as we have been asked to take on more specific consulting projects that, for example, ask us to look at monthly board packages and help an organization decide what information is not necessary, decide how an organization can streamline board meetings and board materials, including what new types of information ought to be included. Likewise, we've had several projects where our charge has been to analyze the organizational chart and scrutinize which parts of the bank report to others and whether a more modern organizational structure should be put into place. If so, what does that even look like? Does the Chief Executive Officer of a community bank need fifteen different direct reports to him or her? Why does our head of retail banking report to our HR/Marketing person? If we create a new treasury management area, should it report through the Chief Financial Officer or the Chief Credit Officer? Those are the types of areas where we see organizations beginning to take a renewed focus and vision for what they are doing. It is possible that what they have always done is working and is successful but may not be providing the greater success the organization can achieve.

So, at the Board of Directors level, we would encourage you to specifically look for things within your organization (processes, procedures, reporting lines of authority, etc.) and ask: are we doing it this way because we have always done it this way even though in a modern organization it would be structured differently? Challenge yourself on why you are doing things and if you do not have a plausible answer other than *"that's the way we've always done it"* then it's probably time to change what you are doing. The new year provides a chance to tackle some of these radical projects that may seem more daunting when focusing on the day to day issues at the Bank in the middle of the year. Let this be the time to present new ideas and address needed changes. If we can help you in evaluating the options, let us know.



Philip Smith is President & CEO of Gerrish Tuck Smith, an ACB Associate Member. You may connect with Philip at (901) 767-0900 or [psmith@gerrish.com](mailto:psmith@gerrish.com).



# Eighth District Farmers Navigate Global Supply Uncertainty

BY NATHAN JEFFERSON and JACK FULLER

The global agriculture sector is no stranger to price swings, but the past few years have presented several shocks in rapid succession. Disruptions related to COVID-19 and shortages accompanying global conflict, along with price increases, have all contributed to greater uncertainty for domestic farmers. But there is good news for agricultural firms navigating these issues: A strong financial position has given the sector much-needed stability moving forward.

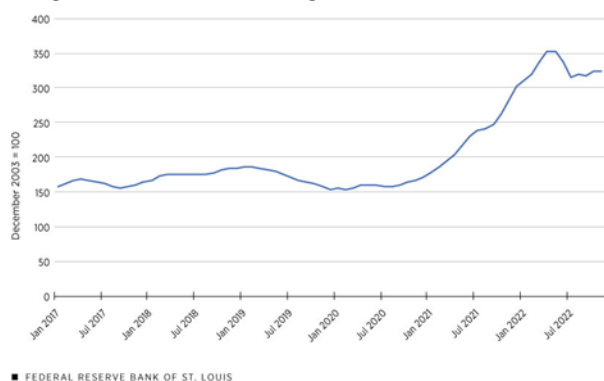
Even before Russia's invasion of Ukraine in February 2022, the agricultural industry had been dealing with global disruptions that brought shortages and price increases in key inputs. Chief among these was the rapid rise in fertilizer prices in 2021.

Commercial fertilizers are a critical input for agriculture across the globe, although specific requirements for type and application vary by region and crop. Fertilizer production relies on chemical inputs to create synthetic nutrients; modern commercial fertilizers are manufactured by mixing atmospheric nitrogen with hydrogen from natural gas to create ammonia, which is then typically mixed with phosphorus and potassium.

While fertilizer demand is global, the resources needed to produce it are not. Canada, Russia and Belarus supply two-thirds of the world's potassium.<sup>1</sup> Likewise, China produced more than 35% of global phosphorus from 2017 to 2019. This concentration of key materials means that disruptions in a few countries can raise global prices and produce shortages.

An untimely combination of supply chain bottlenecks, natural disasters and global upheaval has led to just this outcome. In late August 2021, Hurricane Ida disrupted chemical production on the U.S. Gulf Coast. China implemented new customs inspections on fertilizer inputs in October 2021, then restricted fertilizer exports in 2022 to protect its domestic supply. All the while, the same pandemic-related delays that slowed supply chains around the globe also affected chemical shipments. Conditions worsened further when the conflict in Ukraine caused natural gas prices to rise. Subsequent sanctions on Russia and Belarus have contributed to uncertainty in the fertilizer supply because of their effects on the natural gas supply and, by extension, the availability of the ammonia needed to produce nitrogen fertilizers.

## Rising Prices: U.S. PPI for Nitrogen Fertilizer, Jan 2017-Nov 2022



As the above figure illustrates, nitrogen fertilizer prices, as measured by

the producer price index (PPI), rose 77% from December 2020 to December 2021. The PPI measures changes in prices received by domestic producers, so it reflects farmers' input costs. Though the rate of growth slowed slightly in January 2022, prices increased 6.2% in March and 4.1% in April before finally falling slightly in May and June. Prices have remained fairly stable since then.

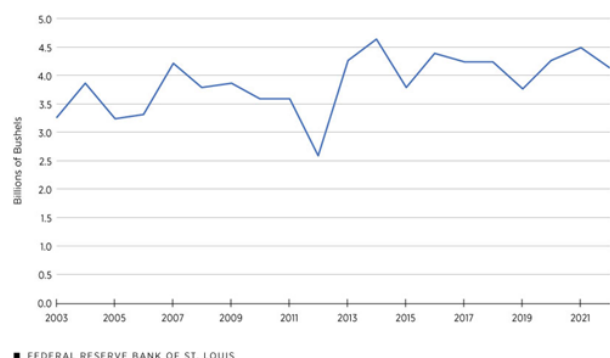
## Impact of Fertilizer Price Increases in the Eighth Federal Reserve District

How will these price increases affect producers in the Eighth Federal Reserve District? First and foremost, it's important to remember that agriculture has significant lags; fertilizer for the 2022 planting season was purchased in 2021, and it will take longer still for the price increases to be passed on to consumers after crops are harvested. However, these price increases likely will be passed on, because crop prices and fertilizer prices are (unsurprisingly) highly correlated.

Despite these lags, changes in crop composition already are visible. Corn requires more nitrogen fertilizer than soybeans do, because soybeans work with bacteria to pull nitrogen from the atmosphere (a process known as nitrogen fixing). Because of this, some farmers have shifted their crop mixes with the goal of using less fertilizer, replacing corn with soybeans and other less fertilizer-intensive crops.

This effect is being felt across the Eighth District and nationally. As the figures below show, corn production in the region fell 7.8% from 2021 to 2022, while soybean production rose 6.6% during that same period. These figures are drawn from state-level U.S. Department of Agriculture (USDA) data and include the states that fall entirely or partially within the Eighth District: Arkansas, Illinois, Indiana, Kentucky, Mississippi, Missouri and Tennessee.

## Corn Production in the Eighth District, 2003-2022

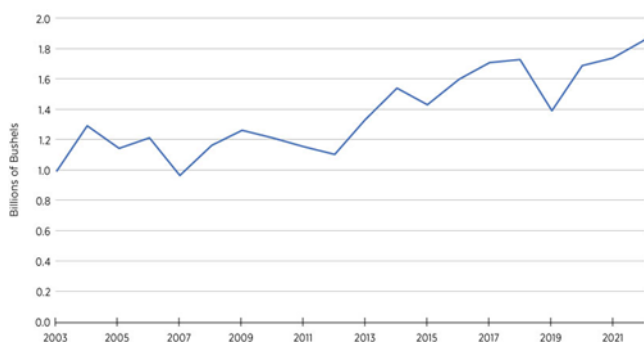


Nathan Jefferson (above) is an associate economist at the Federal Reserve Bank of St. Louis.

Jack Fuller (below) is a research associate also at the Federal Reserve Bank of St. Louis.



## Soybean Production in the Eighth District, 2003-2022



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Nationally, the USDA's [August 2022 World Agricultural Supply and Demand Estimates report \(PDF\)](#) downgraded forecasts for corn production and yields from July and raised forecasts for soybean production and yields. Similarly, the [July 2022 Purdue University-CME Group Ag Economy Barometer report](#) indicated that of the farmers who planned to shift their crop mixes, almost half anticipated allocating a higher percentage of their acreage to soybeans.

To combat fertilizer price increases, regional farmers have grouped together to order fertilizer as a collective. The benefits of doing so are straightforward: Because the collective, or co-op, can make a significantly larger order than any individual, it can attempt to lock in prices that are more manageable for single farmers. Regional farmers have noted that these unofficial buying structures have become more common as fertilizer price increases continue to impact corn and soybean farmers.

### Summer 2022 Shocks

Fertilizer prices are just one issue facing the agriculture sector. The unavailability of mechanical parts also has been a challenge for farmers, with agricultural equipment subject to the same raw material and computer chip supply chain issues that have hampered auto production. Labor, too, became a point of concern during the pandemic, though the end of pandemic-related travel and immigration restrictions have brought relief on this front.

More recently, weather events and commodity price swings have produced uncertainty in the agriculture sector. Drought in the U.S. Southwest and flooding in the Great Plains have reduced production in both regions. Record heat and meager rainfall prompted U.S. cotton farmers to reduce their cotton acreage last growing season; the USDA forecasted a domestic cotton harvest 28% lower than the previous year's, which would mark the smallest harvest since 2009. Although some areas of the Eighth District were impacted by floods or drought, the region as a whole avoided large-scale disruptive weather events during the 2022 planting season, which has helped corn and soybean production remain largely on normal trend.

### Financial Position

The agriculture sector endures shocks and price fluctuations as a matter of course. And while farmers may be concerned about uncertainty, measures of financial stress indicate that the sector is in a better position than it was in previous financial crises. The USDA's debt service and debt-to-asset ratios have risen slightly in recent years, but they remain well below where they were in the farm crises of the 1980s. The sector maintains ample liquidity, and the Farm Credit Administration reports strong credit quality; the share of nonperforming loans reached a five-year low of 0.45% in 2021. While this measure rose slightly to 0.49% in the first half of 2022, it remains below the 0.79% recorded in 2019.

Self-reported measures of financial stability tell a similar story. While conditions have weakened in recent months, agricultural producers are well clear of all-time lows. The Purdue University Farm Financial Performance Index, which measures current financial conditions among farmers, sat at 91 in November, up from 86 in October.<sup>2</sup> While down from 113 in December 2021, recent upward movement reflects high crop prices and strong revenue expectations for the current year. Longer-term expectations are softer, however, with Purdue University's Farm Capital Investment Index at an all-time low of 31 in November.<sup>3</sup> Reports from Eighth District agricultural producers delivered the same message: While rising interest rates and input costs could affect the market in 2023, for the time being farmers remain on stable financial ground.

### Eighth District Farmers Weather Global Disruptions

Fertilizer is a critical input for global agriculture. An untimely series of shocks has reduced the global supply of fertilizer and other agricultural inputs and increased delivery times, raising prices and generating uncertainty for farmers across the world. Nonetheless, Eighth District farmers largely remain in a solid financial position. In response to the rise in fertilizer prices, they have adjusted the distribution of their row crops and formed purchasing co-ops to negotiate for better sales terms.

### Notes

1. See the June 2022 U.S. Department of Agriculture report [Impacts and Repercussions of Price Increases on the Global Fertilizer Market](#).
2. See the [December 2022 Purdue University-CME Group Ag Economy Barometer report](#).
3. Again, see the [December 2022 Purdue University-CME Group Ag Economy Barometer report](#).



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## What is “Quiet Hiring”?

BY BYRON EARNHEART

By this point, I am sure that we’ve all heard what “quiet quitting” is and there has been a good deal of discussion around the topic. Rightfully so. It is something that we have to realize is going on as well as find a way to address it before it becomes cancerous in our banks. A bank can hire all the best consultants on Earth, draw up the greatest catchphrases and hashtags, and even have the cleanest loan portfolio ever assembled in all of history but if there is a *sub rosa* culture of quiet quitting, that bank is dead in the water. No amount of strategic planning will succeed unless that issue is fully resolved.

So, what is “quiet hiring”? I found [this article](#) while getting my coffee ready and I was intrigued by the question of “just what the heck are they talking about here?!”

“Quiet hiring” is defined by Emily Rose McRae from Gartner as what happens “when an organization acquires new skills without actually hiring new full-time employees”. After looking at the idea a bit longer and thinking about this idea’s implications on community banking, let me offer a new definition of “strategically efficient skills growth”.

There are a couple of things I find interesting as it pertains to community banks. The first one is we are the OG’s of quiet hiring! We’ve been quiet hiring before it was cool!!! By a show of hands, how many reading this have seen their career in banking shift into many different areas of the bank...areas you may not have known even existed when you started? (You can put your hands down now...thank you for playing along!) Community banks have always had to build a bench of personnel from within their own ranks.

Another interesting aspect of this idea of quiet hiring is that we see the workforce *wanting* this to happen. They *want* to pick up additional skills to further their career. They *want* to work for a company that takes the time to bolster personal development. The trick to all of this

can be outlined in the famous Richard Branson quote “Train people well enough so they can leave; treat them well enough so they don’t want to”. Again, like so much else in banking, it comes down to the culture and what the bank wants to be.

Let’s cut through all the quotes and management-speak and take a look at what this looks like in a bank and it starts with two questions:

1. Are there any skills your bank need to develop in order to remain relevant in the next 5 years?
2. Do any of your people have any extra time on their hands?

Now, before you answer question 2 with a hard “NO!”...Stop and think a minute. How is your foot traffic in your branches? Are any of the CSR’s or back office personnel doing any task the same way they’ve always done it? (Right there, you will get a good sense of your efficiencies/inefficiencies). **Question 2 is not about having extra time on their hands now...it’s about could they have extra time that could be put to better/more efficient use for the bank.**

Also, nobody wants to do more work for the sake of doing more work. Do they have a reason to do it? *Have they bought into the vision of the bank and what the banks wants to be?*

Quiet hiring, then, is not eating up already thin bandwidth from overworked and underpaid bankers. If that was the case the quitting you will see will no longer be quiet! Quiet hiring is, as I defined it earlier, strategically and efficiently growing the skill set of your employees.

Said another way...play the cards you’re dealt the best possible way. The game is going to change. It changes every day. It changes with every Fed meeting. It changes with loan or deposit product sold. What does not change as frequently is composition of your staff and in order to remain viable, we have to identify in the staff what skills we excel in and what we are lacking.

Filling those gaps, then, is quiet hiring...and it must be as central to your bank’s culture as your lending policy, KYC plan, or even sponsoring the Little League team.



Byron Earnheart is Programming Director at Barret School of Banking in Memphis, TN, an ACB Preferred Solutions Provider.





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<sup>2</sup> Vericast client data

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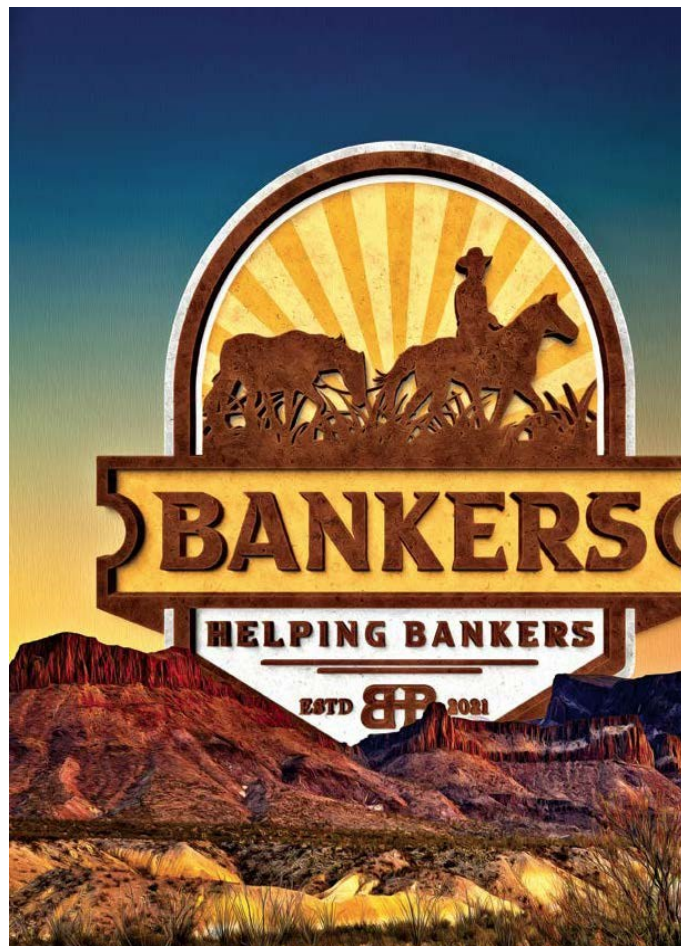


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Sources: [1] Devenir Research. "2020 Year-End HSA Market Statistics & Trends." March 2021. [2] Devenir Research. "2020 Devenir & HSA Council Demographic Survey." June 2021.



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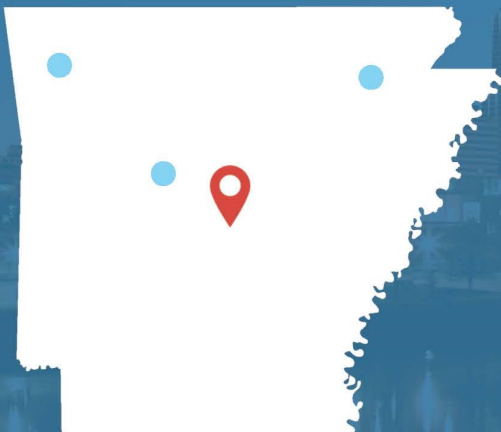
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