Regulatory Update & Focus For Your Next Exam

regulatory

Summary: Everyone agrees that 2020 was a rough year. However, in hearing from regulators lately, it sounds like we may have gotten through the worst of it. They report that 95% of small banks have CAMELS ratings of 1 or 2. We pass on more of these highlights through an overview of the industry and what to expect from the coming exams.

Webinars are not new. They have been around for close to 30Ys as a business tool. In 1993, it was even used as the first live stream of a rock concert with the precursor of today's ubiquitous online video technology. Webinars have come a long way since the 1990s.

Recognizing the importance of technological advancements, the Fed provides many webinars as a channel to share information with bankers and provide a forum for questions. In one of its August webinars, the Fed asked bankers how they thought their communities were faring today vs. last year. About 73% of bankers believed the communities that they serve are stronger or the same today as last year. We have likely passed the worst of the pandemic.

The regulatory agencies' view on the state of the banking industry seems to support this, with some caveats. So, we will explore the highlights that they are witnessing in the banking industry and how that might influence upcoming exams.

Overview of the industry

Resilience. Regulators "*applaud the industry for its resilience during unprecedented times.*" CAMELS ratings remain stable as of August 2021 with 95% of small banks having CAMELS 1 or 2 and 99% of those considered well-capitalized. Regulators noted that they have not seen deterioration in credit portfolios and FIs still have a significant influx of deposits. In aggregate, there is $3.3T in new deposits, reducing liquidity concerns. Many FIs are keeping deposits in cash due to the uncertainty still existing.

CFIs were at elevated levels of capital before the pandemic and this trend continues. Asset quality continues to be strong with only 2.7% of loans that were deferred or modified as of August 2021. Thus, the CAMELS "C" and "A" are less of a concern for now.

Challenges. There are still ongoing challenges and regulators have heard the concerns of FIs. Supply chains are still tighter than desired and affecting some businesses more than others. Labor shortages persist, adversely affecting small businesses as well. Lending demand remains at an all-time low, despite low interest rates. Fast-paced technology is hard to keep up with for many FIs as well.

Consolidation and partnerships. For many of these reasons, the banking industry continues to consolidate, as financial institutions (FIs) try to compete with innovative solutions and augment their loan portfolios. Digital partnerships have also increased since the pandemic. In the West, for example, one-third of the region's FIs have partnerships with fintechs. These partnerships facilitated digital origination of PPP loans and new digital tools for consumer and small business account opening.

What to expect in the coming exams

So, given all these changes in the industry, how will this affect your upcoming exam with your regulatory agency?

Covering more ground. Examiners are aware of unique conditions enduring due to the pandemic. Yet, in the new normal, they have expressed interest in IT, operating, and strategic risks. The examiners are making more efforts to enhance supervision and will be asking about new risks since the pandemic and how they affect your institution. For instance, have you managed cyber risk well with increased digital banking usage? Also, how are you addressing changing customer behaviors? Does your institution have elevated risk due to the labor migration? If so, how was it mitigated?

Larger file reviews. Regulators will be going back to “larger file review” exams and increasing the size of the loan sample for grading and underwriting, beginning today, September 30, 2021. However, examiners will continue to not criticize FIs if they have worked prudently with borrowers during the pandemic. Examiners will be looking for solid policies and procedures to back up those efforts and for FIs to keep incorporating lessons learned during the pandemic. Their focus will be on capital ratios, liquidity management, along with management’s responses in assessing, monitoring, and remediating risks, given known conditions. Be prepared to discuss balance sheet changes and anticipated changes in liquidity.

Shifted approach. Also starting September 30, 2021, regulators will be transitioning away from the pandemic approach, but integrating some of the elements used. During the pandemic, there were more touchpoints added between the agencies and financial institutions to help identify and mitigate risk. Video conferencing was used as in-person exams were more difficult. Expect your next examination to incorporate video conferencing, at least partially, even as exams get back to normal.

There are shifts in the way exams will be conducted from now on. However, regulators are aware of the ongoing challenges. Now is the time to update your risk appetite statements and risk assessments for the new normal before your next exam.

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ECONOMY & RATES

Rates As Of: 09/30/2021 05:18AM (GMT-0700)

Treasury	Yields	MTD Chg	YTD Chg
3M	0.04	0.00	-0.05
6M	0.05	-0.01	-0.04
1Y	0.09	0.01	-0.02
2Y	0.30	0.09	0.17
5Y	1.01	0.23	0.64
10Y	1.54	0.22	0.61
30Y	2.08	0.14	0.43
FF Market	**FF Disc**		**IORB**

0.08	0.25	0.15
SOFR	**Prime**	**OBFR**
0.05	3.25	0.07