FORVIS

2022 AICPA & CIMA Conference on Banks & Savings Institutions

FORVIS Highlights

October 2022

Introduction

The American Institute of Certified Public Accountants (AICPA) and Chartered Institute of Management Accountants (CIMA) held the annual Conference on Banks & Savings Institutions in-person and virtually on September 12 through 14, 2022. **FORVIS** was honored to be an event sponsor again this year. The following are selected comments from various speakers at the conference. This summary doesn't capture all discussions presented during the three-day period; rather, it's intended to highlight trending topics and recurring themes. The selections below are our interpretation of the speakers' comments and do not necessarily represent the opinion of FORVIS.

Key Takeaways

Cryptocurrency | ESG | Pending Recession/Inflation

- **Cryptocurrency**: Cryptocurrency is beginning to be more commonplace in business and consumer spending and investing. Accounting for cryptocurrency was mentioned by each regulatory agency that presented and was identified as a top priority by many seeking counsel from regulatory agencies.
- **ESG**: Environmental, Social, and Governance (ESG) continues to be a hot topic as issuers have begun including additional disclosures to filings. As ESG data and information appears more frequently in filings, so do questions surrounding accounting, regulation, and internal controls.
- **Pending Recession/Inflation**: Many predictions were made over the course of the conference related to inflation levels and the timing of the next recession. While predictions varied, it was unanimous that inflation is here to stay for the near term and a recession is coming.

This summary represents a collaborative effort of FORVIS professionals who attended the conference in-person and online.

Economic Updates

Economic Outlook: Biden's Agenda, Inflation, & Growth

Peter Morici, PhD – Professor at the Smith School of Business at University of Maryland

Morici began the conference with economic humor but spent the next hour providing a tepid outlook on the short-term economy. In retrospect, his humor was appreciated given the outlook. His topics ranged from historical gross domestic product (GDP) and labor statistics to the current macroeconomic environment and Biden's current political economic agenda. He ended with his own view on economic forecasts for 2023.

Morici started by sharing U.S. GDP growth measured by presidential term, from Reagan to Trump. Despite the party in power, GDP has consistently grown through these administrations (between 1.9–3.4%). While Biden is only midway through his presidency, his first two years have been far from ordinary since assuming his role during a pandemic. In a short time in office, Biden has implemented many items from his agenda. Morici stated that while Biden has been a successful president from the perspective of implementing his agenda, we have yet to see the full effects on the overall economy.

Moving to a presentation of our current macroeconomic environment, Morici focused on how COVID-19 has likely permanently changed the world in many ways—where we work, how we shop, and how it has increased our reliance on technology ahead of planned innovations.

The shift in consumer and workforce habits, namely a shift from city to suburban living and work, has caused a mismatch in the labor market. This is the result of increasing the supply of less-skilled workers, since many city-focused jobs have become obsolete, as well as increasing the demand for highly skilled workers as the demand for new technologies to support remote working also has grown.

Consumer spending drastically shifted during the pandemic as well. Despite the hardships felt throughout the economy during the pandemic, $2.5 trillion of $5 trillion designated COVID-19 funds remain in household checking accounts, according to a review of consumer bank account balances pre- and post-pandemic. State and local governments also have increased levels of cash from previous years. The increased product demand that comes with excess consumer cash, combined with Biden policy initiatives and other external factors, has resulted in the highest levels of inflation the U.S. has seen in 40 years. Morici noted that there are no easy solutions to reducing inflation. The most effective solution involves decreasing demand, which is typically achieved by raising interest rates and increasing taxes. Combatting the historic inflation is the focus of the Federal Reserve; but it's not as straightforward as in previous periods of inflation—especially with the current housing shortage, which will only be amplified by raising interest rates. Morici noted that while the increase in interest rates has been higher than those seen in recent years, they are still not as severe as those of the Volcker era. As a result, he expects interest rates will continue to rise and increased rates will be long-term in nature.

Morici concluded with his personal opinions on 2023 forecasts. He prefaced his projections by stating that the 2022 economy has seen a few quarters of negative growth, which he predicts will be followed by a few quarters of positive growth to end 2022, especially considering the impact of the 2022 elections. His 2023 forecasts include annual .3% GDP growth, 4.5% consumer price index, 4.3% unemployment, 4.375% federal funds rate, and 4.80% 10-Year Treasury rate.

Housing Update

Douglas Duncan, PhD – Senior Vice President & Chief Economist, Fannie Mae

Economic Update

Duncan opened his remarks by walking back through recent historical events to provide clarity for what's happening today regarding the U.S. economy.

- 1978 – The Humphrey-Hawkins Full Employment Act was passed by Congress to guide the federal government in achieving full employment, price stability, and balancing the federal budget.
- 1979 – Paul Volcker was appointed chairman of the Federal Reserve at a time of high inflation—approximately 11%.
- 1985 – The Gramm-Rudman-Hollings Act (the Balanced Budget and Emergency Deficit Control Act) was passed to bring down the national deficit and control inflation.
- 1989 – The Berlin Wall fell, and a general mind shift occurred among the public that the last big evil had been defeated.
- 2001 – This was the last year where the federal government ran a budget surplus. Current 2022 deficit levels are as high as they were during World War II.

He noted that beginning in 2022, a paradigm shift has occurred where the world looks much like it did prior to 1989. The difference now is that those in leadership positions prior to 1989 have all retired and those now leading our country, in terms of making monetary and fiscal policies, do not have experience in dealing with the present economic situation. Along with high inflation, there are changes in trade, with impacts felt due to the war in Ukraine, as well as the desire to decarbonize economic activity. These changes are time-consuming, expensive to deal with, and very different from what we've experienced in the recent past. In May 2022, economists concluded they had been too optimistic. The recent inflation numbers that came out in September 2022 suggest the fight against inflation will be more challenging than anticipated. Economists still believe a recession is likely to occur by the beginning of 2023, but whether it will be as mild as forecasted or deeper remains to be seen.

The big question remains: What tools will the Federal Reserve and federal government use to lower the inflation rate back down to the targeted 2%? Typically, the main tool the Federal Reserve uses to regulate the economy is by adjusting the federal funds rate, which is the interest rate banks charge each other for short-term loans. The higher the rate, the lower the demand between banks to borrow money due to increased interest expense.

- Will the Fed continue to increase the federal funds rate?
- Will the government show some fiscal restraint?
- How fast will they work to achieve the target?

Duncan believes the federal funds rate will exceed 4% by the end of the year and likely continue to increase to 5% before stabilizing.

Housing Update

Duncan noted that the recent pull back in mortgage rates from highs in June 2022 only modestly improves affordability for homebuyers. The housing supply continues to be far weaker than historical relationships; the housing supply problem started during the last recession (2008–2010 era), when there was a huge exit of labor, and the supply chain of new houses declined by 75–80%. Supply is typically inelastic in the housing market, and the mismatch between demand for housing (which remains strong due to demand by millennials looking to purchase their first home) and supply will continue. Home prices continue to remain elevated relative to incomes, though there have been declines over the past several months, with certain markets seeing a higher percentage decline than others. Duncan believes mortgage interest rates will remain in the 5–6% range for the foreseeable future—consistent with the average rate since World War II but painful when compared to the rates of the past 14 years.

In addition to impacts on homebuyers, the increased rate environment affects financial institutions, causing a decrease in both mortgage production and refinance demands. According to Duncan, total mortgage production (purchase and refis) began decreasing in late 2020 but saw a significant slow down in the first two quarters of 2022. Refinancing levels fell to pre-pandemic levels not seen since early 2019.

SEC, PCAOB, & FASB Updates

SEC Updates from the Office of the Chief Accountant

Paul Munter – Acting Chief Accountant, Office of the Chief Accountant at SEC

Kevin Vaughn – Senior Associate Chief Accountant, Office of the Chief Accountant at SEC

The clear priority of the Office of the Chief Accountant (OCA) is the investor; the OCA views itself as an investor protection agency and their goal is providing information to investors so they can make informed capital investment decisions. The topics covered were presented from the perspective of how registrants and auditors can and should provide information that is useful in decision making to investors.

The three pillars needed to accomplish this goal include:

- High-quality accounting standards and rules
- High-quality application of these standards and rules
- High-quality audit completed by an independent auditor

The OCA sees the financial reporting process as a communication activity, and registrants should view it only as a compliance activity. Registrants should focus on how best to communicate their activities in a useful manner for investors.

With that in mind, the utmost importance should be placed on high quality financial reporting in the uncertain economic environment we're experiencing today. Preparers need to consider how these uncertainties could affect their organization and how they can be summarized and communicated to investors. The biggest disclosure challenge has been finding and disclosing information related to current estimates that are susceptible to change in the near term and communicating how these changing factors in the current uncertainty could differ from periods of stability. Preparers should also consider if additional estimate disclosures are needed to clearly explain uncertainties to investors regarding potentially changing inputs, assumptions, and methods.

One topic that registrants might consider and apply for the first time in several years is ASC 255: Changing Prices. This topic provides guidance on how to report the effects of changing prices, or inflation, on the financial statements of business entities. In addition, it addresses both general inflation and price changes of certain assets. Due to the current inflationary environment, registrants should consider whether this ASC is applicable to their situation and/or there are disclosures that should now be included.

The current economic environment is not only affecting registrants with new challenges but there are consequences to the audit process as well. Auditors should be considering whether there are new or additional critical audit matters (CAMs)[1] to report and should maintain a heightened sense of due care and professional skepticism. In an environment with economic uncertainty, there are increased risk factors that should be considered during the risk assessment process as well as throughout the audit. All considerations should be documented, especially if assessed risks are recalibrated to address these specific risks.

The OCA also touched on the importance of auditor independence, which has been a common theme over the last year. The confidence investors have is greatly increased if the information they receive has been through a quality audit process. They believe investors should know all the relationships between the auditor and registrant and that independence must exist both in fact and appearance. The SEC is exploring options to determine if there should be further enhancements to current independence standards as more complex business relationships and divestitures have started to occur.

Finally, the OCA discussed materiality and the importance of disclosing material information, the importance of materiality evaluations, and how preparers and auditors should use a quantitative and qualitative evaluation—not a mechanical calculation.

Several standards and items are on the OCA's agenda related to digital assets and software cost. They're also seeing a wide range of consultations from registrants related to business combinations, consolidation, digital assets, and revenue recognition.

[1] pcaobus.org/oversight/standards/auditing-standards/details/AS3101

SEC Updates from Corporation Finance & Office of the Chief Accountant

Rachel Mincin, Senior Associate Chief Accountant – SEC
Stephanie Sullivan, Associate Chief Accountant – SEC

Mincin and Sullivan first discussed recent enforcement actions and consultation themes.

- There was a recent enforcement action against a bank, which received a cease-and-desist order related to a level three instrument based on the securitization of commercial real estate loans where significant gains were recognized. The order included violations related to internal controls where the bank failed to incorporate all available market data in their analysis, nor did they appropriately document their assumptions/rationale regarding their approach to the fair value of the instrument and conclusion reached.
- The SEC continues to receive quite a few consultations regarding materiality. When an error in the financial statements is identified, the registrant must evaluate the error based on materiality and the guidance included in SAB 99, which includes both quantitative and qualitative considerations. They emphasized that lowercase "r" restatements are still a correction of an error, even though prior periods were not restated.
- Several comment letters recently have been issued regarding the risk factors included in the MD&A, particularly the inclusion of any disclaimers regarding the reasonableness of accounting done in accordance with GAAP. Registrants will want to look at the language in their disclosures closely to ensure they're not disclaiming this.

Ms. Mincin noted that a "Dear CFO" letter was recently published regarding disclosures related to Russia's invasion of Ukraine and the event's potential impact on critical accounting estimates. They reminded the audience that these Dear CFO letters are issued to provide clarity on various topics and the guidance should be incorporated into registrants' filings, where applicable.

The speakers noted that Disclosure Topics 9 and 9A related to the COVID-19 pandemic are still relevant and any impacts to registrants' businesses due to the pandemic should continue to be disclosed. These include any changes to operations or costs that are new or now permanent. The expectation is that anything materially significant would still continue to be disclosed.

Ms. Sullivan shared observations regarding new Guide 3 disclosures after the first year of implementation. She pointed out that many registrants didn't include any disclosure of how the number of insured deposits were determined, including whether it was a precise number or an estimate—and if an estimate, how the estimate was derived. In addition, if there are foreign deposits that are uninsured, registrants should disclose the regulatory guidance from the applicable country. The detail included in this disclosure varied across registrants—some providing little information; others providing more detail. She also noted diversity in practice regarding the disclosure of the loan maturity table and fixed versus variable rate loan table.

FASB Update

Susan Cosper – Board Member, FASB
Hillary Salo – Technical Director, FASB

FASB Agenda Consultation

In June 2021, the Financial Accounting Standards Board (FASB) published an Invitation to Comment (ITC) to obtain feedback from stakeholders for determining the future focus of standard setting. Initial results were shared at last year's conference; however, the comment period was still open.

The comment period closed in late 2021. FASB announced a new research agenda in December 2021 and issued its *FASB Agenda Consultation Report* in the first half of 2022. These were the top five priorities noted by financial institution ITC respondents:

- ESG-Related Transactions & Disclosures
- Digital Assets/Cryptocurrency
- Software Capitalization Accounting & Disclosures
- Definition of a Derivative
- Interpretive Process

These items were formally added to the technical or research agenda:

1. **Accounting for and disclosure of digital assets** – The objective is to improve the recognition, measurement, presentation, and disclosure of digital assets. The board discussed scope in its August meeting and is currently researching and performing outreach to determine measurement alternatives.
2. **Accounting for and disclosure of software costs** – The objective is to modernize the accounting for software costs and enhance transparency about an entity's software costs. Current paths being explored include requiring a single capitalization model, updating existing models, and expensing all software costs.
3. **Accounting for financial instruments with ESG-linked features (research project)** – FASB is currently researching financial instruments linked to sustainability initiatives, indices, or targets to consider how ESG-related provisions within financial instruments should be accounted for.

CECL PIR

FASB continued its Current Expected Credit Losses (CECL) post-implementation review (PIR), seeking feedback from users, adopters, and nonadopters. The continued feedback has resulted in these issued Accounting Standards Updates (ASU):

1. **Accounting for TDRs by creditors** – FASB issued ASU 2022-02 in March 2022, which removes troubled debt restructuring (TDR) measurement and recognition guidance for entities that have adopted CECL and enhance disclosures for modifications made to borrowers experiencing financial difficulties.
2. **Vintage disclosures clarification** – Also included in ASU 2022-02 was clarification regarding charge-off and recovery disclosure by year of origination. The ASU will require entities to disclose gross charge-offs, but not recoveries, by year of origination.
3. **Accounting for acquired financial assets** – FASB has determined the purchased credit-deteriorated accounting model should apply to all acquired financial instruments, with limited exceptions. This is meant to isolate fair value adjustments due to interest rates from credit adjustments and prevent net interest margin from being distorted and keep it a comparable benchmark between acquisitive and non-acquisitive financial institutions. FASB is currently performing research and additional outreach.

PCAOB Update Summary – 2022 Banking Conference

Barbara Vanich – Acting Chief Auditor, Office of the Chief Auditor

Jason Bullington – Regional Associate Director, Division of Registration & Inspections

Representatives from the Public Company Accounting Oversight Board (PCAOB) provided an update on recent PCAOB standard setting, research activities, and inspection developments.

Standard-Setting Activities

Vanich first shared an update on the PCAOB's recent standard-setting and research activities, which are highlighted below:

- The board approved amendments to the PCAOB's auditing standards intended to strengthen requirements that apply to audits involving multiple audit firms.
- The PCAOB continues work on an updated standard to enhance and strengthen requirements related to a firm's system of quality control. The board intends to create scalable standards, allowing a firm to tailor its quality control systems appropriately based on the size, complexity, and nature of engagement.
- Other topics still being considered include revisions to AS 2405, Illegal Acts by Clients, auditor's evaluation and reporting a company's ability to continue, and the confirmation process in light of changes in technology.
- The board is also focused on its research projects related to audit evidence (with a focus on evidence from technology-based tools and the use of external data) and data and technology.

Inspection Activities

Bullington shared that the PCAOB's primary objective is responding to the financial reporting and audit risks being driven by the recent economic environment. Some of these risks included the continued negative effects of the COVID-19 pandemic, such as widespread disruption in supply chains, increased volatility in financial and commodity markets due to changing interest rates, and inflationary trends. Other risks included audit firmwide risks like the heightened degree of staff turnover and risks arising from auditing in a remote environment, which includes the risk that auditors would not identify material misstatements. The staff continues to focus on auditing areas likely affected by the pandemic, including impairments, going concern, allowance for credits losses, and increased risk of fraud. The PCAOB also continues to place emphasis on audit procedures performed in audits for IPOs, SPACs, and related merger transactions.

Bullington noted that inspections continue to enhance their focus on a firm's quality control standards, moving towards a more preventive regulatory approach. Regarding inspections of the audits of financial institutions, Bullington observed that financial institutions generally make up approximately 20% of audits subject to inspection.

The allowance for credit losses and other estimates, including fair value measurements, *e.g.*, valuation of investment securities, comprise the most frequent areas of audit deficiencies. Below includes an incomplete list of noted audit deficiencies where auditors did not:

- Sufficiently test significant inputs and assumptions, including failures to evaluate evidence that supported changes or lack of changes
- Test the design and operating effectiveness of controls that include a review element. For example, audit firms did not sufficiently evaluate specific review procedures that control owners performed and whether the judgments made in performing those activities were reasonable and supportable. Nor did they assess the criteria used by the control owners to identify matters for further investigation and whether the items identified for follow up were appropriately resolved
- Test controls over the accuracy and completeness of issuer-prepared data or reports used in the operation of controls

Specifically related to CECL, Bullington noted that the PCAOB continues to perform procedures to understand firms' readiness to audit the adoption of CECL. Early inspection results observed sufficient auditors and issuers attention devoted to CECL implementation. However, the PCAOB has noted instances where auditors did not test or sufficiently test models and/or related controls over those models developed in a prior period in preparation for day one implementation during the year under audit or during the year when CECL was first effective.

The PCAOB stated the COVID-19 pandemic continues to be a challenge to an issuer's ability to estimate loan loss provisions. The board also noted that financial institutions rely much more heavily on qualitative adjustments to model outputs than in the past, because certain relationships that have driven model outputs are less reliable. The subjectivity inherent in these adjustments and other similar types of overlays has presented additional challenges for auditors to sufficiently evaluate and test.

In closing, the PCAOB encouraged audit firms to ensure their quality control systems are appropriately designed and operate effectively. This will guarantee policies and procedures related to the use of a service provider provide reasonable assurance that engagement teams comply with professional standards pertaining to maintaining control over confirmation requests and responses.

Regulatory Updates

Federal Banking Agencies: A Fireside Chat with the Chief Accountants

Shannon Beattie – FDIC
Amanda Freedle – OCC
Lara Lylozian – Federal Reserve

The chief accountants for the Federal Reserve, OCC, and FDIC were present to provide their insights on CECL, climate risk, and Call Report updates.

CECL

Freedle observed that while CECL was stressed during the global pandemic, it has performed as intended as institutions were able to record losses earlier during the pandemic and weren't limited by the probable threshold under incurred loss model. She noted the industry saw allowance builds in 2020 and corresponding declines in 2021, largely due to government stimulus offered to borrowers. Regulators were comfortable with these trends and felt they were appropriate under the circumstances.

All representatives discussed industry credit metrics and how no deterioration has been seen yet, but that institutions must still closely monitor their borrowers for potential declines. Freedle noted that the current environment makes it challenging to select appropriate economic scenarios for a reasonable and supportable forecast because of continued uncertainty. Due to the uncertainties, if an entity elects to use a weighted scenario approach, it was discussed that this election requires significant documentation to support management's conclusions on the appropriateness of the selected forecasts and their applied weights.

2023 CECL Adopters

Lylozian focused on a discussion of the next round of CECL adopters in 2023, which are mostly smaller and less complex community banks. The Federal Reserve has created tools to help community banks take a meaningful step toward adopting this standard without implementing a complex model solution.

- Expected Loss Estimator (ELE) is an Excel-based tool that automates the WARM method. This is a simple spreadsheet with verifiable formulas that uses a bank's own data. The ELE model tries to solve for the complexity in the math within the WARM calculation.

- SCALE is a simplified spreadsheet tool that uses publicly available data from Call Reports to approximate expected loss rates. The SCALE model tries to solve for lifetime loss rates using bank and peer data and potentially incorporates qualitative adjustments, reasonable and supportable economic forecasts, and estimated prepayments, which could reduce the overall effort in calculation of an estimate.

Based on guidance from the Federal Reserve, although both SCALE and ELE tools are simple spreadsheet-based tools developed by the Federal Reserve to assist community financial institutions with calculating the ACLs, the ELE tool is separate from SCALE. The ELE tool applies the WARM method and relies on data and assumptions supplied by financial institution management. The SCALE tool applies the SCALE method and uses publicly available data from Schedule RI-C of the Call Report to derive initial proxy expected lifetime loss rates. In addition, the SCALE tool is only appropriate for financial institutions with total assets of less than $1 billion, while the ELE tool could potentially be appropriate for some community financial institutions over this threshold.

Regarding the regulators' expectations for smaller banks' adoption of CECL, a common theme between the panelists was that CECL for smaller institutions doesn't have to be overly complex, and can be scaled to the institution's size and complexity. Regulators will be focused on the data quality, the bank's established policies and methodology, and whether there were any audit findings from either internal audit or external audit. All representatives noted that their examiners have been trained to understand the theory behind various methodologies and understand supervisory expectations.

Beattie noted that 347 institutions have already implemented CECL and more than 4,000 institutions have yet to adopt in 2023. Each agency discussed that they weren't expecting anything unique for the validation of a bank's CECL model, and banks should focus on existing regulatory guidance regarding model risk management and model governance. The agencies held a webinar in 2019 to address applying CECL models at larger financial institutions and, although focused on larger banks, many of the principles discussed can be applied to all institutions.

Climate Risk

Beattie noted that the FDIC requested comment on climate-related financial risks for large banks and the comment period closed June 2022. They are developing a high-level framework for exposures related to climate-related financial risks. This is focused on institutions with $100 billion or more in consolidated assets.

Lylozian noted that the Fed's responsibilities relate to ensuring safe and sound banking practices and monitoring how banks are assessing risks such as climate-related risks. She noted the Fed is being thoughtful regarding potential changes to regulatory reporting and will take time to finalize any changes.

Freedle noted the OCC has issued draft principles and is still evaluating feedback. She also commented that climate risk is just another type of risk, and bankers are already good at managing risk. She stated the OCC has hired a new climate risk manager, Dr. Yue Chen. Chen's role will focus on helping the agency assess, monitor, and manage climate-related risks to banks.

Call Report Updates

Beattie reported there are no planned updates to forms for the September 2022 Call Report. The June 2022 Call Report instructions included information on Staff Accounting Bulletin No. 121 for entities with obligations to safeguard crypto assets and for those that adopted new accounting guidance on fair value hedging, expanding from the single layer method to the portfolio layer method. The March 2022 Call Report instructions featured information for those that adopted the new TDR guidance early. She also noted the COVID-19 temporary asset threshold relief has expired.

Perspectives on the Regulatory Landscape

Rodgin Cohen – Senior Chairman, Sullivan & Cromwell LLP

Cohen shared his views on four main topics:

1. Current Regulatory Environment

Several industry updates have transpired within the last eighteen months:

- New leaders presiding over the Federal Reserve, FDIC, and CFPB – This could drive policy changes with a focus on financial inclusion and consumer protection.
- Shift in the regulator's supervisory approach – There's been an uptick in regulator findings, resulting in written deficiencies, MRAs, and MRIAs. The prime culprits seem to be insufficient internal controls across the board, AML, and cyber and consumer compliance. In addition, data deficiencies (concerning the completeness and accuracy of nonfinancial data) are a trending issue.
- Enforcement actions – These are perhaps more muted than expected given the second bullet above, but there still have been some recent high-profile actions in the news relating to the mishandling of payments and impermissible sales practices.

2. M&A

"What a difference a year makes." – Cohen noted a sharp decline in merger activity in the last six months after seeing a resurgence in 2021. The market value of the largest transaction in the last six months ranks only as the 31st largest since 2020. Cohen cited these reasons for the decline:

- Heightened uncertainty about the future course of the economy. There is a psychological element associated with decline as institutions are less willing to take risks due to inflation, geopolitical instability, and the continued impact of COVID-19.
- There's inflation in the market value of investment securities and fixed-rate loans due to interest rate hikes. There could be negative impact on the accounting treatment for purchasers.
- Uncertainty in the industry related to the position of regulatory bodies and the Department of Justice on mergers in general. Will regulators insist on certain qualifications, *e.g.*, new resolution plan requirements, closure of matters requiring attention/matters requiring immediate attention, and a reduction in less than satisfactory examination ratings, *i.e.*, fix-it-first mentality, before approving a transaction?

3. Cryptocurrencies

Cohen acknowledged the lack of movement, proposals, and overall non-update (in the past year) by regulators or lawmakers to regulate the currencies. We have yet to see regulations on private sector currencies and even enforcement actions are sporadic and ad-hoc. Regulators have warned financial institutions to not participate or engage in crypto activities due to several potential factors:

- There may no longer be a consensus among regulatory bodies on regulation.
- There doesn't seem to be a banking or industry-wide prioritization or framework.
- The crypto winter, *i.e.*, downturn, has made the market nervous and the industry needs a clear understanding of the risks and regulatory structure and controls before moving too far down a certain path.

Cohen also touched on the Federal Reserve's topic of a central bank digital currency (CBDC). While the Fed has made no decisions on whether to pursue or implement a CBDC, they have been exploring the potential benefits and risks of CBDCs from a variety of angles.

4. ESG

Cohen shared his views on ESG, noting one hot button topic of late that, while not receiving as much attention, relates to the political implications and overall environment that fit somewhere within ESG. Corporate positions on politically divisive issues and social rights continue to impact an institution's reputation and overall perception by the general public. There are no magic formulas or easy answers when it comes to political issues, but these are some basic guidelines for institutions to follow:

- Speaking or making a statement on a political topic may not be the best course of action on certain issues.
- Silence often may not be feasible either. So, if compelled to speak or make a statement, it must be centrally coordinated with executive management and authorized accordingly.
- The decision whether to speak/make a statement or not should be made promptly.
- Promptly is different than hastily—financial institutions shouldn't rush it.
- In reaching a decision on certain issues, the guiding principle should be the financial institution's reputation.
- Be prepared for reactions that will arise and plan accordingly. Think ahead on responses to political and socially charged issues.

Lastly, Cohen touched on the SEC's proposed climate-related disclosure rule released in March 2022 that would require registrants to include certain climate-related disclosures in their registration statements and periodic reports. This includes information about climate-related risks that are reasonably likely to have a material impact on a registrant's business, results of operations or financial condition, and certain climate-related financial statement metrics in a note to their audited financial statements.

This could have a potential high compliance cost and impact on financial institutions as it would mean the organization isn't only responsible for its own emissions but any which occur in the upstream and downstream activities of a registrant's value chain. The SEC has proposed to define "value chain" broadly as the upstream and downstream activities related to a registrant's operations, *e.g.*, borrowers, securities holders, and insurers.

Cyber Risk & Regulatory Compliance 101 for Non-Security Financial & Accounting Business Leaders

Tiffany Kleemann, Managing Director of Clients & Markets – Cyber & Strategic Risk Practice, Deloitte & Touche LLP

Organizations are facing a growing need for cybersecurity and resilience as hackers are committing attacks with greater frequency and efficiency. Current cyberattacks require as little as 18 minutes from the moment of the breach to achieving the hacker's objective, which highlights the need for strong cyber defense, as well as a robust response and recover plan.

Regulatory Landscape

Recognizing the growing threat cyberattacks pose to the investing public, the SEC has proposed rules and amendments to enhance and standardize disclosures regarding cybersecurity risk management, strategy, governance, and incident reporting by public companies that are subject to the reporting requirements of the Securities Exchange Act of 1934. Specifically, the proposal would:

- Require current reporting about material cybersecurity incidents on Form 8-K
- Require periodic disclosures regarding, among other things:
  - A registrant's policies and procedures to identify and manage cybersecurity risks
  - Management's role in implementing cybersecurity policies and procedures
  - Board of directors' cybersecurity expertise, if any, and its oversight of cybersecurity risk
  - Updates about previously reported material cybersecurity incidents

- Require cybersecurity disclosures be presented in Inline eXtensible Business Reporting Language.

The proposed amendments are designed to better inform investors about a registrant's risk management, strategy, and governance as well as provide timely notification of material cybersecurity incidents. Consistent, comparable, and decision-useful disclosures would allow investors to evaluate registrants' exposure to cybersecurity risks and incidents, as well as their ability to manage and mitigate those risks and incidents.

Technical Accounting Topics

Fintech Accounting Issues: What You Need to Know!

Daniel Goerlich – Partner, PwC
Andrew Mense – Director, PwC

This session focused on the evolution of financial technology (fintech) companies and differences in fundamental accounting and financial reporting issues that arise as traditional banking joins forces with fintech.

Evolving Fintech Landscape

The term "fintech" describes any business that uses technology to modify, enhance, or automate financial services for businesses or consumers. Examples include:

Mobile Banking Apps	Personal Finance Apps	Peer-to-Peer Payment Services
Peer-to-Peer Lending Platforms	Robo Apps	Cryptocurrency Trading

A top priority for most fintechs is the customer experience, which has led to the realization that the best designed apps drive customer retention. The relationships between fintechs and banking is a natural fit because banks are interested in technology and the goal of many fintechs is to offer financial services. As more banks partner with fintechs to offer shared services, the distinction between the two industries will blur.

Fintech Reporting

As banks look to partner with fintechs, either through an investment, partnership, or acquisition, banks need to understand the key performance indicators (KPIs) and non-GAAP measurements of the tech industry to understand the business model and value proposition. Common KPIs are transaction volume, *i.e.*, number of payment transactions; customers, *i.e.*, number of customers; average customer age; growth, *i.e.*, new subscribers, and interaction, *i.e.*, engagement and daily login. Tech companies are traditionally revenue-driven and focus in on EBITDA and free cash flow to tell their equity story; they also are balance sheet light, which is the opposite of a bank.

Accounting Implications

The presenters highlighted that partnering with a fintech brings to light new accounting implications that may have previously been deemed not relevant to a traditional bank's accounting focus. Four FASB Accounting Topics should be revisited for any bank considering partnering with a fintech:

- Consolidation – consideration as to whether the transaction should be accounted for as joint venture, equity method investment, or consolidated
- Revenue from Contracts with Customers (ASC 606) – following the five-step model for each product or service. Complexities may arise and contracts should be heavily scrutinized

- Sales of Financial Assets (ASC 860) – sharing data and increased collaboration on banking services could expose banks to additional risks around financial assets historically reported
- Compensation – compensation packages are evolving to meet the needs of highly skilled talent. Less traditional compensation offerings require new accounting analyses to ensure proper treatment

One last issue presented is that many tech start-ups have multiple rounds of capital raises. For banks and others that initially invest and record an equity security carried at cost, the investment may need to be written up or down in value if it's determined there is a readily determinable fair value that is ultimately observable.

Mid-Size Bank Chief Accounting Officer Panel

Nancy Maloney – CAO, Huntington Bank
Ryan Richards – Corporate Controller, Zions Bancorporation
David Cornish – CAO, Santander U.S.

The panel covered several hot topics in banking, sharing views and experiences from their respective institutions.

CECL

The main items discussed were challenges related to adoption, data required for adoption, modeling and projections, and comparability issues between institutions post-adoption due to different modeling techniques and portfolios, including acquired loans, etc. Another topic for discussion centered around whether to include pandemic-era loan and loss data in the historical data used in CECL modeling. There were a variety of viewpoints since some feel it's better to exclude pandemic-era data due to the unusual nature; however, others think it should be included as historic data and in the modeling. Despite different perspectives between the institutions, all bankers agreed that spending additional time on completing thorough CECL documentation, specifically related to adoption, is critical.

Data Governance

The next topic was data governance and specific advances that have been made related to data in the panelists' banks. Panelists agreed that it's critical to think of data as an end-to-end concept and fully understand what data looks like from the beginning source to the end output. This includes understanding how the data gets consumed and used throughout the process.

Efficiency

Efficiency in terms of modernization was discussed, meaning that there is a desire for most banks to meet customers where they are. Technological advances in other industries, especially the fintech space, are pressuring banks to make sure their digital toolset is leading in the market. Key improvements and efficiencies discussed were bolstering the bank's payment and treasury management tools, improving remote deposit capture, implementing payment solutions (like Zelle), improving the interactive voice system for call centers, and modernizing the core system with a move towards real-time processing.

ESG

This discussion centered on who at each bank is involved with ESG and who owns the process. Based on the discussion, a wide variety of individuals appear to be involved in ESG disclosures, including legal, investor relations, credit, risk, capital markets, CEO, CFO, accounting, and the SOX/SEC team. Much of the reported ESG data is nonfinancial in nature, and the capture and management of that data is different from traditional data sources used in financial disclosures. If ESG data is coming from nonfinancial areas of the bank that may not feature a robust controls structure, management should verify there are internal controls over the creation of the related ESG disclosures to help ensure consistency and accuracy.

Community Bank Financial Reporting Hot Topics

Sydney K. Garmong – Partner, Crowe LLP
Mike Lundberg – Partner, RSM US LLP
Todd Sprang – Principal, CliftonLarsonAllen LLP

Topics discussed by the panel included observations on CECL implementation, changes to TDR accounting, available-for-sale (AFS) debt securities, and related credit impairment in the current environment.

CECL Implementation – It's Time!

The panelists opened the session with reminders, lessons learned, and best practices on CECL implementation for everyone who hasn't yet adopted the new standard. They were hopeful that 2023 adopters are bringing closure to their implementation projects, pointing out that now is the time to be realistic about the project status. If adopters are not comfortable with the status, or if implementation isn't going to be ready as planned, now is the time to change course to a more simplistic model. The goal is to be in compliance with the new standard by January 1, 2023. The model can always be enhanced after implementation.

Key reminders for CECL implementation included a focus on internal controls. Panelists observed that CECL is a fundamentally different model and will likely require new or redesigned controls, suggesting as a best practice to implement controls as the model is developed at each key step: model selection, segmentation, data, qualitative adjustments, forecasting, reversion, and so on. Further, for December 31, 2022 year-end financial statements and internal controls over disclosures of the adoption, the impact must be considered.

Panelists reflected upon experiences and lessons learned from early adopters who implemented in 2020, noting that more than 150 financial institution SEC registrants adopted during that time. Key observations included the following:

- Implementations took a significant amount of time and resources. Previous experience in financial modeling or stress testing was meaningful to the process.
- Loss estimates derived under CECL may not be comparable between companies, even those with similar size and geography.
- There are differences in working with or using third parties to develop the CECL estimate, and the management review controls that need to be in place around calibration, customization, and outputs are essential and likely more in-depth than more common, in-house models (that were) previously used.
- Adopters underestimated the importance new qualitative factor frameworks would have on the overall estimate and how much time and effort it would take to create new factors.
- Model validations require a substantial amount of time if done correctly and to be of value to the implementation process; adopters should understand the process and avoid losing time in the process.
- Parallel runs, model stress testing, and continuing to test and refine post-adoption should all be factored into the implementation process.
- Avoid the use of qualitative factors to bridge the gap or anchor a predetermined total loss estimate. If possible, build in guardrails to the qualitative factor methodology using a matrix-type decisioning framework, within reason. Recognize that judgement ultimately needs to be a part of this process, providing for balance and flexibility.

Panelists also discussed several available resources for preparers, auditors, and other key stakeholders from a governance perspective, including the AICPA's "Allowance for Credit Losses – Audit Considerations Practice Aid" (Sept. 2019); "AICPA Audit and Accounting Guide for Credit Losses," with a preface that includes implementation observations as a bridge from the previously published Practice Aid; and the Center for Audit Quality's tool for audit committees, "Preparing for the New Credit Losses Standard" (May 2019), noting that even though this is a few years old, it is still highly relevant.

Removing TDR Accounting & Enhancing Disclosures

FASB Accounting Standards Update 2022-02 issued March 31, 2022 will be effective for years beginning December 15, 2022, and has the option for early adoption for those who have already adopted CECL. The update removes TDR accounting from a recognition and measurement perspective and enhances disclosures for loan modifications. Panelists commented on expected challenges for financial institutions implementing this update, noting it's just a different process now but a subtle shift causing the significance of this update can be overlooked and potentially missed. Without TDR accounting, measurement of impairment is no longer affected and, while it becomes just a disclosure standard for loan modifications with concessions to borrowers experiencing financial difficulty, it doesn't mean it's any less important to users of the financial statements. Financial institutions must ensure policies and procedures are updated, systems are updated to track this information, training is conducted for the appropriate loan operations personnel, and financial reporting mechanisms and controls are in place to comply with the update.

Credit Impairment Considerations for AFS Debt Securities

The current, significant decline in the AFS debt securities portfolio of many financial institutions may be primarily the result of general market conditions, which reflects prospects for the entire economy rather than information pertaining to a specific industry or issuer. When evaluating for other than temporary credit impairment, or credit losses if under CECL, accounting guidance directs entities to consider the intent and ability of the holder to retain its investment for a period sufficient to allow for any anticipated recovery in market value.

Panelists pointed out that this specific factor pertaining to the holder's "intent and ability" could be challenged given the uncertain timeframe for anticipated recovery, coupled with the potential near-term liquidity needs of an institution due to deposit runoff, increasing loan demand, etc., that can only be satisfied with sales of AFS securities. Panelists suggested reviewing the duration of the AFS portfolio in comparison to cash available and time commitments of other liquidity sources, as well as performing a type of look-back test on management's assertion regarding intent to hold and being mindful of unintended consequences.

The ESG Business Case: Perspectives from Bankers

Andrew S. Nix – EVP, Chief Governance Officer, Deputy General Counsel, Assistant Corporate Secretary Regions Bank
Michael Tovey – CPA, Corporate Controller, Bank of America
Grant R. Haines – Partner, EY

ESG reporting continues to unfold during 2022 as investors, regulators, employees, customers, and other stakeholders have increasing interest. This session included two bankers who shared their journey on the ever-evolving ESG reporting landscape. The emphasis on ESG is well underway and not only includes SEC disclosure requirements and regulatory guidance that impact regulatory capital, but also a change that will be generational. Investors, suppliers, and customers expect bankers to exhibit a higher standard in this area. ESG started as a communications issue to increase transparency into what companies were doing but has now evolved into a discussion of data, goals, metrics, and reporting on progress. ESG is connected to the core value of delivering superior, long-term, and consistent performance to investors.

Panelists discussed their experience and interactions with regulators regarding ESG. Contrary to many discussions surrounding accounting and SEC reporting, discussions around ESG are evolving and continue to explore how to incorporate reported metrics into capital and liquidity planning. The SEC is working to provide workable, practical guidelines, since a common theme on the proposed SEC rules for climate-related disclosures is the challenge of increasing compliance cost.

Panelists next discussed the impact of ESG on mergers and acquisitions. Since banking is an acquisition-oriented industry, the topic of ESG must be added to the list of considerations when evaluating potential targets. It will serve an acquirer well to be mindful of their own internal ESG priorities and compare that to targets, as well as to think about that integration early on and how it would flow into the combined organization.

Finally, panelists discussed lessons learned in their ESG journeys. It's apparent that institutions are in vastly different stages of evaluating ESG. The structure of monitoring and reporting varies by organization. A few lessons learned from the panelists include:

- Try to match ESG priorities with strategic goals.
- Have a cross-functional team. Don't forget about reporting needs, as well as internal controls.
- Look at peer disclosures. Identify institutions on the same playing field and begin conversations with these institutions by sharing ideas and benefiting from various experiences and knowledge.
- Start early. There will likely be gaps. This process should be approached similar to implementing any other major accounting standard.
- Start conversations with your audit firm. Discuss expectations, implementation plans, and any needs for third-party assistance.

Understanding Risk & Hedging – Back to the Basics

Mathew Foley – BDO USA, LLP Valuation and Capital Market Analytics

True to his presentation title, Foley began with the definition of a hedge, noting that a hedge is a form of insurance that investors can use to protect themselves against a negative impact on their balance sheet or investment. He made sure to note that hedging will not prevent all negative events from occurring, but rather, if executed properly, hedges will reduce the impact of the negative event. The most common risks facing financial institutions are market risk, credit risk, and operational risk. Foley stressed that risk isn't the expected loss—it's the potential of the unexpected loss.

When considering a hedge, Foley noted several pros and cons to consider.

Pros included limiting or offsetting loss, protecting profits, and increasing risk management.

Cons included the skill and expertise required, costs associated with entering into the transaction, data needed, and documentation.

The presentation first focused on credit risk, which falls primarily into two categories: credit default risk and concentration risk. Credit default risk occurs when a borrower is unable to meet payment obligations. Concentration risk is when many of a bank's loans fall into specific borrowers, sectors, or industries. Since there are limits to traditional credit risk management activities, credit derivatives act as an alternative transfer method that can offer additional risk management. Credit default swaps and total return swaps are two types of credit derivatives that can help offset credit risk. This is typically achieved by making periodic payments to the seller of the swap and, in return, the institution would receive a payment to be made whole if a credit event occurs.

Foley next discussed interest rate risk and the hedging instruments available to manage interest rate volatility. Interest rate risk is defined as the gain or loss that arises due to sensitivity of the interest income/expense expenditure or values of assets/liabilities to market interest rate fluctuations. Interest rate risk can impact investments, loans, and outstanding debt at an institution. Interest rate derivatives may be used to manage risk from unfavorable movements in interest rates and achieve desired balance of both fixed and variable rates; the most common approach being the use of an interest rate swap. In an interest rate swap, one party agrees to pay a variable rate to a counter party for the receipt of a fixed rate in return, or vice versa. Interest rate swaps can exchange fixed or floating rates to reduce or increase exposure to interest rate fluctuations.

Foley took questions from attendees, during which he informed the audience that interest rate swaps were the most common derivates used by financial institutions today and emphasized that, overall, the accounting documentation related to any hedge is very important and should be detailed in nature and consist of more than just a short memo on the transaction.

Strategy & Planning

You've Got Talent: Building a Workforce for the Future

Shannon Flynn – Executive Director at JPMorgan Chase Bank
Stefanie Coleman – Principal People Advisory Services at EY
Eric Newell – EVP Chief Financial Officer at Equity Bank

The U.S. labor market is in a unique position—the existing supply of labor isn't in sync with current labor demands, which has resulted in a very competitive talent market. After recovering from the record unemployment from the pandemic, unemployment in June 2021 was 5.9% and continued to further fall in June 2022 to 3.6%.

Values Matter

Increased competition has allowed employees to be more selective in their expectations of their employers. The current supply of workers, especially the new workforce generation entering the labor market, expects to understand their potential career path and available learning opportunities for a given position.

Providing a clear career path is not only invaluable to employees but creating a detailed succession plan is also of high value to the success of a company. In addition, regulators have been focused on succession planning for critical and complex roles within an organization. The process to identify the best successor for a given role can be time-consuming and requires data gathering. Both interpersonal and technical skills are important data points and it's critical that the future leader be someone who will emulate the company's culture. Leadership trainings/academies are great tools to develop identified leaders for succession, which benefit both the employee and organization in the long run.

Other retention strategies in the current labor market include providing opportunities for employees to take on stretch assignments that wouldn't be available in the employee's standard job function, rotating employees from one department to another (short-term or long-term), and participating in short-term talent exchanges/swaps. These practices can help uncover hidden talents or skillsets.

Historically, efforts to retain employees helped increase worker satisfaction, leading to prolonged employment; however, in the current competitive labor market, it's reported that 30% of workers respond that they'll move on to another opportunity without having their next opportunity in place, indicating that the tolerance for workplace dissatisfaction is much lower than in the past.

Becoming a Talent Destination

The numbers show there is increased pressure to attract and retain employees: 33% of employees are actively looking for a new role and 54% say they are open to a change. Three main considerations that workers have when looking for a new workplace:

1. **Onboarding** – Make sure employees understand how their job contributes to the organization, how it impacts their co-workers, company strategy, and the community. If possible, give the potential employee a taste of the company's culture before they join and make the candidate feel valued before they even start. Set employees up for success not just technically but also culturally.
2. **Remote Work** – 79% of workers want flexibility when and where they work. 49% will look for new job if forced back into office full-time. This is a complex decision on what will work best for your company and culture.
3. **Competitive Compensation** – Compensation and overarching benefits must be competitive to keep an organization in the running, but they are not the main differentiator. Differentiators can be career path, sense of purpose, and company values. Emerging generations tend to embrace personal values and social impact and want to see that reflected in the company they choose to work for. Compensation is critical but other values can be what really matter.

The Ins & Outs of Effective Scenario Planning

Heather Hinchley – Syntellis Performance Solutions

To start off the second day of the conference, Heather Hinchley provided a presentation on effective scenario planning, which focused on a planning horizon that consists of three levels of data to process and provide to management for strategic planning:

	TYPICAL # OF YEARS COVERING				
	1	2	3	4	5
Budgeting	3 months to 1 year				
Forecasting	1 to 3 years				
Scenario Planning			3 to 5 years		

The challenges associated with processing these pillars of planning revolve around the accuracy of the plan, efficiency of the plan, and accountability of the plan to meet and reach the financial institution's goals. The budgets of many financial institutions can be static and rigid to the point that they're only updated annually. The solution is to be agile, replan, and reforecast throughout the year with a systematic approach that doesn't require more than one or two employees to update budgets, forecasts, and scenario planning in a timely, accountable fashion. Recently (2020–2021 with the pandemic), financial institutions needed to pivot quickly and provide frequently updated forecasts to management and boards of directors to allow these teams to be more nimble in their decision making; however, many financial institutions have archaic tools and processes that didn't allow this data to be efficiently and accurately updated.

Hinchley quoted metrics from the "Syntellis Performance Solutions: CFO Outlook for Financial Institutions 2021 and 2022" to illustrate scenario planning throughout the industry:

- In late 2020, only 38% of financial institutions planned to use scenario analysis in 2021 (but 57% over $1B in total assets planned to use it)
- 73% model the impact of internal and external drivers in the near-term (1–5 years)

- 62% evaluate budgets under different assumptions and economic conditions
- 25% evaluate strategic initiatives to make go versus no-go decisions

Challenges in 2022 facing scenario analysis include a rising rate environment, interest margin compression, loan-to-deposit ratios (deposit growth experienced during the pandemic has placed challenges on how to deploy these funds with loans), and rising non-interest expenses (technology costs, people costs, and inflationary pressures from vendors). To tackle these challenges, Hinchley offered these best practices to help financial institutions properly develop and deploy scenario analysis:

- Develop plan
- Run multiple scenarios
  - Expected case scenario
  - Best-case scenario
  - Worst-case scenario
  - Mix-and-match scenarios
- Understand the financial impact
- Understand the operational impact

The Future of Humalogy in Banking

Scott Klososky – Founding Partner, Future Point of View

In today's society, the utility connectivity between individuals and technology for both consumer and business needs has never been greater. Scott Kosolosky, the founding partner of Future Point of View, warned that this connection is here to stay, and companies need to make decisions now to adapt to the changing landscape of the integration of technology and humanity.

Experts believe that like the technological revolution of the early 20th century, the next major period of change is happening right now, and the period from 2000 to 2005 will be a bellcurve of innovation resulting in transformational change potentially more impactful than the combustion engine. According to Kosolosky, as technology and automation become more prevalent, bank leaders face a strategic choice to find the ideal balance between automation and human touch (known as the Humalogy Scale).

According to Kosolosky, the banking industry today is a partially augmented level; where customers have several online self-serve tools, paperless processes, and cloud-based core systems. However, in the next five years, the industry is expected to shift to a more augmented level as predictive analytics, artificial intelligence-driven automation, and Web3 financial services become more mature.

Some of the major expected changes banks will face in the near future include;

- **Currency** – digital currencies with very different properties than today's currencies are here to stay. Financial institutions will need to adapt and prepare for widespread utilization.
- **Identity** – How individuals are recognized as a person or organization on the web, *e.g.*, avatars, blockchain naming, biometrics, will transition from multiple username/accounts to a singular transportable profile.
- **Value & Ownership** – How value is assigned and created for digital assets and ownership information (digital titles) is shifting as regulations and standards are being developed. The ways in which these assets are utilized and measured as part of normal financial activities, *e.g.*, NFTs as collateral, will be a change for banks.

- **Experience** – How people interface and experience information, people, and environments through extended reality. Data is becoming dematerialized, democratized, and distributed.
- **Quantification** – New methods are being developed for scoring and measuring people and organizations, *e.g.*, trust, ESG, likes, and popularity.

Balance Sheet Strategy

Scott Hildenbrand – Piper |Sandler

The presentation focused on best practices related to asset/liability strategies and key takeaways observed by participating in asset/liability strategy sessions with the presenter's clients throughout the year.

One significant observation is that a majority of asset/liability committees (ALCOs) focus on where interest rates are headed versus the positioning of the institution's balance sheet. While a committee cannot predict interest rates, they can position themselves for expected future changes. Successful ALCO committees are strategic and forward-thinking, and focus on balance sheet positioning to determine their exposure, strategies to address the exposure, and strategy implementation.

Successful ALCO committees strategically analyze their balance sheet exposure relative to the current yield curve and develop strategies to address such exposure when competing with other institutions on loan products and deposit offerings. Specific proactive considerations for today's yield curve environment include:

Think About Balance Sheet Mix

- Most ALCO committee participants are too concerned about where interest rates are going and should be focusing on where their balance sheet is going to change
- The market is on the verge of a major deposit mix shift due to the artificial deposit increase from recent COVID-19 stimulus programs. Consider revisiting the deposit mix from 2019 as the institution's deposit mix will likely shift back to the pre-COVID-19 mix.
- CD specials are not the answer. An alternative approach to consider is to offer money market accounts tied to the federal funds rates and consider a hedging strategy to convert that portfolio utilizing interest rate swaps.

Stop Focusing on Parallel Interest Rate Shocks

- 80% of interest rate spread business is based on 20% of the yield curve. Understand the parts of the yield curves that matter to the institution and implement strategies for those considerations.
- Local market competition drives the institution's cost of funds, not the Federal Reserve. The institution's model for determining cost of funds should be determined through a careful analysis of five to ten top competitor's loan to deposit ratios. Attempt to analyze the competitor's potential to change their deposit rates based on their liquidity needs and related loan to deposit ratio.
- Since a majority of the yield curve is short-term, *i.e.*, two years, determine an alternative spread of a five-year Treasury when pricing a five-year commercial real estate loan and consider if the institution is getting compensated for the credit risk on the smaller spread on the loan.

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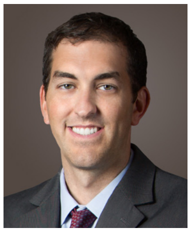

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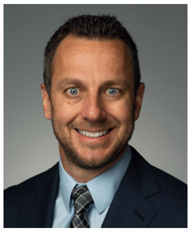

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