POSSIBILITIES

INSIGHTS FOR FINANCIAL INSTITUTIONS | SPRING 2018

CONVERSATION WITH BILL STOVALL

Possibilities recently sat down with Bill Stovall, CEO of Community National Bank in Texas, to hear his thoughts on the current state of the banking industry.

POSSIBILITIES: Community National Bank is approaching its 35th anniversary, growing from one location to 10 in that time. What are the keys to continued success?

Bill: Our success is really due to our people and making a decision to bring in young talent. We made sure to bring in some experienced bankers as well, but we've really had a lot of success recruiting and growing our own team. That has given us quality people from top to bottom who understand our economy. We all remember 2016 as a tough year, but because our people were so well-trained, we got through it, especially on the credit side. We had just as good of an exam that year as we would expect in good times. We have good processes, and that's because we have good people who are committed to the bank and our success. We have a loyal employee base. I know that is not unique to our bank, but we really try to build a culture that our customers and our staff want to be a part of. We've had good people from our competition come to us because they want to be part of our culture, too. Our customer growth is because of our culture.

In addition, we're also trying to diversify and not be as locked into the cycles of the oil and gas industry. We just opened a loan production office in the Dallas-Fort Worth area with the intention of opening a full service branch, though we're being patient. That's been a big event for the bank this past year.

POSSIBILITIES: How do you maintain a culture that attracts community members to the bank?

Bill: We're in competition with the oil companies when it comes to benefits. These large, independent, publicly traded companies offer things such as workout facilities, cafeterias, physicians and daycare on site. So what are we going to do when we can't match that kind of expense? We try to foster a strong culture that's open, honest and flexible. I tell our employees we're not naïve, we know that there are things they would rather do some days instead of coming to work. My hope is that when they get up for work on Monday, they say they are thankful that it's for Community National Bank. We provide a lot of time off for family and for community service. We offer the flexibility to have a life outside of your job. We give staff their birthday off, we have floating holidays, you can buy time off as part of our United Way campaign, and we have fun events throughout the year. We have a Christmas party with a talent show that we model after American Idol. All of a sudden you are seeing employees that say little during the day get up and sing. It's a challenge in this market to keep people, but we have good retention. We take our jobs seriously but we have a good time along the way.

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ABOUT BILL STOVALL

William D. (Bill) Stovall, is chief executive officer of Community National Bank. Bill joined the bank in 1997 as senior vice president and commercial lender. He was one of the organizers of Midland Bancshares, Inc., and was appointed as executive vice president and a director of both the company and the bank upon the acquisition of the bank by the company in February 2000. He was promoted to chief executive officer/chief lending officer in 2013 and gained his current title in 2015.

INSIDE

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BITCOIN 101: A PRIMER ON ONE OF THE HOTTEST CRYPTOCURRENCIES

You have probably heard the term Bitcoin and all the media buzz about this new technological evolution of currency, but you may not understand the clamor. Supporters of Bitcoin, particularly the millennial generation that is accustomed to electronic transactions, will tell you it's a different, some would say better, type of currency, and it's unique in that it has no physical form, just a digital one. Bitcoin is one of the most popular forms of virtual currency, and the only one most people recognize. But it would probably surprise you to know that there are more than 1,000 other cryptocurrencies in circulation.

About Bitcoin

Bitcoin was developed in 2009 by an unknown programmer under the alias Satoshi Nakamoto. Bitcoin has no physical form. It is produced virtually through what is called a "mining" process; a process in which computers solve intricate math problems and are rewarded (well, really the individuals that assist the computers) with Bitcoin for the correct solution. But, the supply of Bitcoin has been limited from the beginning. Under the Bitcoin cryptocurrency system, only 21 million Bitcoin are available to be mined, and it is said that more than 15 million Bitcoin are already in circulation.

Once mined, Bitcoin can be used just like any currency so long as it's accepted, except its primary function is for use online, and the transactions are often done anonymously. According to the IRS, cryptocurrencies such as Bitcoin are classified as "a digital representation of value that functions as a medium of exchange, a unit of account, and/or a store of value." It's important to note that at this point in time, cryptocurrency, including Bitcoin, has legal tender status in extremely few governmental jurisdictions. The U.S. is not one of them, and Bitcoin has no central banking system. However, Bitcoin does fall into the category of "convertible virtual currency," which is a form of virtual currency that can be purchased in or exchanged into real, tangible U.S. dollars.

In the beginning of cryptocurrencies, the primary problem centered around how to create, hold and transfer the cryptocurrencies. Because there is no central banking system for cryptocurrencies, the digital footprint for these virtual currencies is recorded in a virtual digital wallet. Entities were then formed to act much like banks, but without the regulations and oversight, to assist in the one-on-one cryptocurrency transactions and to create historical records of those transactions. Most times the exchanges worked, but other times they did not and some were forced out of the marketplace.

Taxation in General

The IRS says that Bitcoin is to be treated as property for federal tax purposes. This means that the same general tax principles that apply to property transactions will apply to any transaction involving cryptocurrencies. Under these principles, taxpayers receiving Bitcoin in exchange for providing goods or services will recognize income equal to the fair market value of the Bitcoin received on the date of receipt. With the volatility of Bitcoin over the last few years, and particularly the last few months, this could indicate a very wide range of values.

Bitcoin is still a fairly new technology, which means tax treatment of virtual currency transactions is still being developed. However, with the increase in use and established values, it is likely to gain more interest from the IRS.

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TAX REFORM: ANOTHER LONG PROCESS AHEAD

When President Trump signed the Tax Cuts & Jobs Act into law last Dec. 22, many breathed a sigh of relief, happy that the long, hard road to passing tax reform was over. The “passing” piece was indeed complete, but the “implementation” part of the new legislation is another process entirely.

Clarification on many pieces of the legislation have been sought, and as recently as May 9, the House Ways & Means Committee was planning a “Phase II” tax reform plan that would largely be pointed towards individual provisions and families. This additional phase of tax reform legislation could make the individual tax cuts in the act permanent, rather than expiring at the end of 2025, which was required to comply with Senate budget rules. This new potential legislation may also affect education incentives and retirement savings planning. More to come on these developments.

Section 199A Deduction Clarification

The U.S. Treasury is expected to release guidance this summer for interpreting the provisions in the Tax Cuts & Jobs Act and applying the new rules. Of great importance to community bankers is the application of new Section 199A, which provides a deduction for “Qualified Business Income” (QBI) equal to 20 percent of QBI, with certain limitations. This deduction is for individual taxpayers and activities conducted within passthrough entities, such as S corporations and partnerships.

Questions have arisen from some commentators whether “banking” definitely is an activity that will produce QBI and qualify for this deduction. On April 30, the ABA, ICBA and Subchapter S Bank Association sent a joint letter to representatives at the Treasury requesting that future guidance clearly include banking as an activity that will qualify. The legislative language makes references to other Internal Revenue Code provisions indicating that Section 199A is meant to apply to banks, but still leaves many with questions. Eide Bailly tax professionals have had recent discussions with Senate staff who drafted the legislative language, and we received assurance that it was the intent of Congress to include banking as being eligible for the 20 percent deduction. It is now up to the Treasury to clarify that intent and explain how this valuable provision will be calculated on income tax returns.

It is expected this guidance may be available this summer. It is paramount for community banks to be clear on this provision, as many banks are analyzing whether an S corporation or a C corporation tax structure would best fit their strategic direction, and this provision is a major part of that analysis. Thus, along with guidance on the mechanics of calculating the deduction, clarity is needed on what activities will produce QBI eligible for the deduction.

One more component of federal tax reform is the impact on state tax laws—will states conform to the new federal rules, or will there be a whole new set of state adjustments for taxpayers to deal with? Many states are grappling with Tax Cuts & Jobs Act provisions now. This area is on our daily watch list.

Other Provisions Impacting Community Banks

Tax Rates: The federal corporate income tax rate was changed to a flat 21 percent rate for C corporations. The maximum rate had been 35 percent, with a lowest bracket of 15 percent. This is an effective tax rate decrease for most C corporation banks, who have already had to deal with this rate change on their Dec. 31, 2017, Call Report, when their deferred tax asset or liability had to be adjusted to reflect this new corporate tax rate. C corporations should be sure to use the new 21 percent federal corporate tax rate on their tax accrual calculations during 2018.

S corporations, when computing tax distribution amounts for 2018, should take into account the new individual tax rate schedule (top marginal bracket is now 37 percent, down from 39.6 percent) and consider the new 20 percent of QBI deduction. The net investment income tax, applicable for certain passive owners of S corporations, is still in place. The Tax Cuts & Jobs Act did not change the net investment income tax rules at all.

Accounting Methods: The opportunity to defer taxable income for C corporation banks has been enhanced by the act, by making available the use of the cash method of accounting for tax purposes for C corporations that have average annual gross receipts of $25 million or less for the prior three years. The prior limitation for C corporations was average gross receipts of $5 million or less for the prior three years and for every year since 1985. The new $25 million threshold will provide an opportunity for many more C corporation banks to defer taxation on accrued interest receivable until the year it is collected. Likewise, accrued interest payable and accrued expenses payable (including accrued bonuses and salaries) are not deducted until the year paid. Careful analysis will need to be done to determine whether this is a change that would benefit a C corporation bank.

It’s important to note this method change would not necessarily have an immediate impact on a bank’s income statement; the deferred income and expenses from using the cash method become components of a deferred tax asset or liability calculation.

The cash method of accounting remains available for all S corporation banks, and the change to the cash method is an automatic change for S corporation banks with average annual gross receipts of $50 million or less. This has been the case since the IRS released Revenue Procedure 2011-14 (although it is possible the IRS could change the gross receipts threshold for the automatic change in the future). For S corporation banks with average annual gross receipts in excess of $50 million, the bank can still change to the cash method, but would need advance consent from the IRS to do so.

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TAX REFORM: PERSPECTIVE FROM A BANKER

After the Tax Cuts and Jobs Act passed last year, one of the first questions it created in the financial institutions industry was about choice of entity. Many S corporation banks are weighing the pros and cons of switching to a C corporation. Possibilities sat down with Justin Horst, CFO of Pinnacle Bancorp Inc. of Nebraska, the second largest S corporation financial holding company in the United States, to talk about what his bank was experiencing and his thoughts on the impact of tax reform.

POSSIBILITIES: Has your organization re-evaluated its S corporation election since tax reform was passed?

Justin: About 67 times (laughs). We went through different iterations as the various House and Senate bills came out and had a model for each to help us know which one to cheer for. We kept track as best we could but it was difficult sometimes to remember what points were in what bill. We're the second biggest S corporation in the industry, so our numbers get pretty big fairly quickly, and a step in the wrong direction can cost a lot of money. We have a September year-end, so we have until almost the end of the year to decide if we will stay an S corporation. We're waiting to see how things end up in the instructions and guidance to ensure we understand everything before we make a final decision.

POSSIBILITIES: What was it like going through the process of watching the different bills unfold and seeing the final product?

Justin: We had some conversations with some Senate aides about the initial pass-through language and how it didn't work. We offered feedback on what was usable and what could be better, and comparing it with what was in the Senate bill. It was interesting to see the process at that level. Some of the stuff that moved around a lot, like corporate AMT, were big deals for C corporations because all your tax-exempt interest was possibly at risk. Thankfully that didn't survive. But I think this will be the year of the technical correction, given how quickly it seemed to go through the approval process.

POSSIBILITIES: How has tax reform impacted your bank's overall operating strategy?

Justin: We've had to look at a lot of what we're invested in because there are winners and losers in everything that we're doing. For example, tax exempt bond portfolios were certainly not winners in this with the lower effective federal rate and a worse net yield. We've also looked closely at our low-income housing credits, which were also negatively impacted because your investment returns aren't as good as they were previously. But overwhelmingly, the majority of the items in the bill are positive.

POSSIBILITIES: How do you think tax reform will impact your growth?

Bill: In terms of growth, we think we'll save about 9 percentage points as an S corporation with the current rates, and we may get another 9 points if we switch to a C corporation, relative to taxable income. Those get to be big numbers. We're a highly acquisitive bank, so that allows more capital to be available, but sellers are figuring that out to because their after-tax return is better. That's driving higher than expected prices from some sellers, though I'm not sure who has gotten those prices. It certainly will increase the multiples on the banks. It has in the public markets, and we're starting to see that in private as well.

POSSIBILITIES: While the C corporation rate changes do not have an expiration date, there is an expiration date of 2025 for the 20 percent qualified business income deduction and the individual rate decreases. Does that give you or your shareholders any apprehension?

Justin: That really weighs heavily on our mind. If those rates were not renewed you'd find it very hard not to switch to a C corporation. And the other side of that is we have a two-year window to switch where there are some benefits in terms of future dividends and rolling in changes to accounting. Our biggest fear is we'd wait to 2025 and then be forced to switch and miss out on the benefits of switching now.

POSSIBILITIES: What have your conversations with regulators been like so far regarding tax reform?

Justin: One thing we've learned as we've talked to regulators, they still don't quite understand our bank's situation. We're in a peer group of $10 billion to $50 billion, and there are only two S corporation banks in that group. We told the regulators they are going to see a lot of earnings hits from the other banks in our peer group, that their capital includes deferred tax assets as well, but they don't seem to understand that as well as they should. It's a complicated topic, and when you put the words "deferred tax" into it, the general public doesn't understand what you're talking about.

POSSIBILITIES: How much do you weigh the ability to book a deferred tax asset when you look at switching to a C corporation?

Justin: It would add to pure common equity if we switched and give us a tier 1 capital boost, plus the savings in each quarterly estimate. But the loss of deductibility of state taxes plays a big

ABOUT JUSTIN HOST

Justin Horst, CPA, CGMA, is chief financial officer of Pinnacle Bancorp, Inc., a multi-state bank privately owned S Corporation financial holding company headquartered in Omaha, Neb., with approximately $10.5 billion in assets. Pinnacle is currently the second largest S Corp financial holding company in the United States and has locations across seven states. His responsibilities include working closely with the banking subsidiaries in merger and acquisitions, financial accounting and tax issues, regulatory issues, strategic planning, technology and operational issues, and budgeting.

role, too. In Nebraska, we have a financial institution tax as a C or S corporation that the bank pays, and for this purpose that actually is beneficial. Other states have something similar as well. Deductibility of those taxes has a big impact on effective rate.

POSSIBILITIES: How do you feel tax reform will impact the industry overall?

Justin: Financial institutions will probably fare better than most other sectors because we had such high effective tax rates to begin with. Lots of other industries have the ability to shift money in a way we don't. There are certainly winners and losers in this, but overall I think our industry is a big winner.

One question that is beginning to surface is what does the individual shareholder see themselves doing over the next five to 10 years? Do they see themselves selling their shares or the whole company selling? That really has an impact on your decision making. Also, there are better estate planning options as an S corporation than a C corporation. If you're looking at doing substantial estate planning or a sale in the next five to 10 years, tax reform will have a strong impact on any decision to switch. Additionally, if you have a lot of operating losses from another company, when your bank income offsets your losses from other investments, you lose that netting if you switch to a C corporation. So it's important for every shareholder to look into the future and try to have a strategic plan, which is uncomfortable for many shareholders to talk about, because if you tell someone you might sell your shares in 10 years, you can't unring that bell. It's bringing some difficult conversations to the table.

POSSIBILITIES: How do you think that compares to when banks could first become S corporations in the 1990s?

Justin: Back then the rates were the same as the federal rate, and when you look at it through that lens, it was easier because you weren't signaling a sale by switching to a S corporation. You were just looking to get the same rate and get basis, too, or potentially pay of distributions tax-free. It's different now that there is such a different tax rate. If you're not considering some of those personal goals and planning, then a C corporation is the clear answer, but unfortunately there's more to the story. And it's probably not going to be unanimous in a shareholder group because everyone has different goals and plans.

POSSIBILITIES: Do you think tax reform will affect lending decisions?

Justin: I think tax reform combined with the rollback in regulations that is happening will make banking more attractive and ultimately more competitive, because I think we're going to see more entries into the industry. Tax and regulatory burdens were pushing people out of the market and creating consolidation. It will be interesting to see if we have less consolidation now, or if banks that can now stay in the business will still want to sell even if they can get high prices.

THE RISKS OF EMPLOYEE EMAILS AND SOCIAL MEDIA

Is a social media account, such as LinkedIn, a personal account? Does your financial institution's Acceptable Use policy address the use of social media for work-related business? What about other external accounts that require a basic profile and email address, such as Facebook, Twitter, travel reservation/membership rewards accounts, etc.? In completing IT reviews, we have advised financial institutions to establish policy and procedures to address any employee-created accounts set up with external service providers. Some have taken the recommendation so far as to prohibit access to such accounts from non-bank workstations and networks.

For the purpose of this discussion, externally created accounts (Facebook, LinkedIn, Twitter, etc.) are considered personal accounts. Here's why:

- The employee creates the accounts without information technology support assistance or administration.
- Risk to the financial institution is increased when an employee uses their work email address for personal/non-bank managed application accounts.
- External accounts are often the basis for a phishing campaign, and since the account is tied to the employee's email address through the bank's domain, the incoming email may look and feel more correct, appearing legitimate. If an employee clicks the link and logs in, now the hacker has intercepted login credentials or can trigger malware installation on the work computer.
- Passwords to external accounts often go unchanged and might be used across multiple systems. If LinkedIn gets breached (again) the password for that account, along with the work email (used as the username for that account) will provide access to any other account where the employee has used the same credentials.

We advise financial institutions to consider the risk of intermingling personal accounts with bank-administered systems. Any external system accounts should also be identified on the user access authorization form. Management can reduce risk to the bank by encouraging employees to keep personal accounts separate from their work-related digital profiles. Best practice is to prohibit combining personal account use with work email addresses, and to also disable use of personal email accounts through email filtering.

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TIPS FOR CECL PREPARATION

Many financial institutions are starting the process for implementing the Current Expected Credit Loss model (CECL). Here are some helpful tips to consider as you begin your implementation.

Lifetime Loss Approach

Many smaller financial institutions are using annual loss experiences to calculate the historical loss rate. The annual loss can no longer be used for calculating the historical loss experience under CECL. The new standard requires the loss rate to be based on some form of lifetime loss approach. The method for calculating the lifetime loss rate is fairly open. If the financial institution plans on piggy backing off their current method of loan loss reserve calculation based on an annual loss rate, modifications to a lifetime loss approach will be required.

The Three Elements to CECL

The calculation of the allowance under CECL equals: Historical Loss Rate +/- Current Economic Conditions/Qualitative Factors +/- Reasonable Forecasted Economic Conditions. Many of the training sessions and discussions on CECL focus on the historical loss calculation and not on the current economic/qualitative factors and the forecasted economic elements of the CECL calculation. As part of the educational process, institutions should be looking for information that covers all aspects of the CECL calculation process.

Historical Data

Obtaining historical loan data maybe difficult or limited. In a recent CECL planning meeting for a small community bank, we recommended using previous monthly board reports that provided various loan information for the month. From this information, the bank was able to calculate its historical loss rate. This is an example of having to be creative in obtaining historical loan information that might not otherwise be available using the traditional loan accounting systems.

Financial institutions will have many questions during the process of implementing CECL, and it will be important to reach out to various individuals, groups, accountants, consultants and others to help you through the process.

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CONVERSATION WITH BILL STOVALL

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POSSIBILITIES: How is the current regulatory environment affecting your bank?

Bill: Since Dodd-Frank, we have followed the book as well as we can. Regulation is always going to be a challenge. The one thing that has been consistent in my 42 years in the industry is change. The federal bill that's been introduced recently could give us some relief in areas such as HMDA, regulatory capital, and examination burdens. We're on a 12-month exam cycle, and if they raise the threshold in regulatory relief, we would go back to an 18-month cycle. But I tell our staff if we're doing what we need to do, it doesn't matter when the exam comes. There's not any single issue that's preventing us from managing and operating our bank the way we want to.

POSSIBILITIES: What do you think are the major concerns currently facing community banks?

Bill: Our market is unique because we are in the oil and gas industry, and it's only been in recent years that we have been able to get through to the regulators that we're a one-trick pony—no matter what type of business we deal with, that business is affected by the oil and gas industry. I think the smaller banks are going to continue to be challenged by the expense of the regulatory burden. We're at a size where we've been able to absorb those costs. Sure, it would be nice to reduce those costs, but it's not affecting how we're performing. I think it's going to be tough for the smaller banks in small communities to get a return that will sustain their operation. We'll likely continue to see more M&A activity. A lot of the competition we have currently are banks that started out in smaller communities and then had to come to the Midland-Odessa markets to survive. It's helped them grow, but there are still many banks who are facing the challenge of being efficient at a certain size.

POSSIBILITIES: How does your bank tackle the challenge of keeping up with technology?

Bill: We have in-house staff who are always in training, always looking into technology trends. The big banks are the ones who create a lot of the products we use, but we like to let them do the testing and marketing to make sure an idea works, and then we base our decisions to change on customer demand. We're really a commercial bank, but a lot of the young people who are creating new success in business want the latest technology. We're making sure we're keeping up and doing our due diligence when vetting new technology for our customers.

POSSIBILITIES: How can community banks ensure they have a successful future?

Bill: Continue to do what we do and understand the purpose of a community bank. We do pretty much the same thing as the big banks, and we tell people that, but we need to keep up with the technology and services. The key is to still foster local commerce and be part of the community. That's something we don't see the larger banks doing any longer, and that's still important. Time will tell, but I think mainly our success is tied to being able to do the right thing, to do what's good for the company and the customer. At Community National Bank, we want every customer to feel like they are the only customer we have. That's been said by a lot of banks, but that's the philosophy I grew up on, and that's the message we were built on, all the way to our front-line tellers.

EIDE BAILLY
ADDS EXPERTISE IN TEXAS

Our firm continues to grow to serve our clients better, and we have added additional financial institution expertise and a new state to our firm with the addition of Texas firm Davis Kinard & Co, PC, who joined Eide Bailly close to the start of the year. The union added 11 partners and 80 staff members to the firm as well as offices in Abilene, Haskell, Plainview and Seymour. Davis Kinard built a great reputation in the financial institutions industry and adds deep expertise to our financial institutions team.

"We'll be able to grow with our clients by offering more resources, and our staff benefit with greater opportunities to advance their careers through training and specialization," said Davis Kinard President/CEO Russell Guthrie.

REGULATORY RELIEF EFFORTS HIGHLIGHT **SHIFTING TIDE** IN BANK REGULATION

The U.S. Senate passed the Economic Growth, Regulatory Relief, and Consumer Protection Act (S. 2155) on March 14. The bill is intended, among other things, to amend the Truth in Lending Act to allow financial institutions with assets under $10 billion to be exempted from the current ability-to-repay requirements for portfolio mortgage loans. While the bill enjoys bipartisan support, many are concerned about the lasting impact the exemption could have; if passed, the bill would allow institutions to lend with increased discretion. The risk? Gone unchecked, discretionary lending could result in bad loans, which could prompt another financial crisis.

Risks and Rewards

The bill has widely been hailed as relief for smaller community banks, but many believe that the $10 billion threshold is too high. Banks with assets under $10 billion make up more than 97 percent of the total banks in the United States. Proponents of the bill argue that the primary tenets of Dodd-Frank were intended for a small number of large, complex financial institutions, and that these changes will allow community bankers to better serve their customers, released from onerous federal oversight.

In addition to concerns over who this bill will serve, the Congressional Budget Office estimates that the proposed legislation will cost taxpayers $671 million over the next 10 years, as riskier mortgage lending increases the likelihood of bank failures. A section of this legislation would also allow custodial banks to alter the calculation of their supplementary leverage ratio (SLR), allowing them to hold less equity to offset losses. Under this provision, large institutions like JPMorgan Chase and Citigroup would be allowed to adjust their SLRs because they perform custodial activities for other banks.

Allowing banks to reverse course on regulatory requirements to become less regulated and less capitalized has many lawmakers and consumers concerned about another financial meltdown.

If banks are able to more easily qualify borrowers for mortgage loans without first verifying their ability to repay, especially with adjustable rate products, it could result in foreclosure and loan loss.

The counter-argument is that banks would only be exempted from aspects of current regulation for loans they are keeping on their own books. Loans sold on the secondary market would need to meet the already established qualified mortgage standards. It stands to reason that banks will be cautious with portfolio lending to avoid losses. But, enough failures on a large scale could, in theory, prompt federal relief funds similar to what was seen a decade ago.

The Bigger Picture

The proposed legislation and the fight over it underscores the current regulatory climate and the uncertainty it faces. The newly appointed director of the Consumer Financial Protection Bureau requested $0 in funding for the current year, while initiating formal inquiries into the effectiveness of the agency. At the same time, federal regulators continue to pursue bad actors and strengthen regulatory requirements, expanding requirements under HMDA and Customer Due Diligence procedures.

After nearly a decade under strict federal regulation, many banks are ready to balance cautious lending with customer service. It remains to be seen what this new legislation will mean for both banks and consumers, or if the pendulum will once again swing back toward more vigorous lending regulations for all banks.

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COMPLIANCE HELPLINE Q&A

Q: What are the requirements and differences between Regulation B and Fair Credit Reporting Act (FCRA) for consumer adverse action notices?

A: When a credit decision is based wholly or in part on information from a source other than from the applicant or from the bank's own files, a combined notice that includes both Regulation B and FCRA disclosure requirements is required.

Regulation B (1002.9(a)) notification content requirements are that the notice be in writing and should contain a statement of the action taken; the name and address of the creditor; a statement of provisions of section 701(a) of the act; the name and address of the bank's federal agency; and either a statement of specific reasons for the action taken or a disclosure of the applicant's right to a statement of specific reasons within 30 days, if the statement is requested within 60 days of the creditor's notification. The disclosure shall include the name, address and telephone number of the person or office from which the statement of reasons can be obtained. If the creditor chooses to provide the reasons orally, the creditor shall also disclose the applicant's right to have them confirmed in writing within 30 days of receiving the applicant's written request for confirmation.

The bank is required by FCRA 615(a) to provide a written disclosure of the credit score used in denying the application along with related information that includes a range of possible credit scores, up to four key factors that adversely affected the applicant's credit score, date which the credit score was created, and the entity providing the credit score. When information is from an affiliate (other than information in a consumer report or other than information concerning the affiliate's own transactions or experiences), the FCRA section 615(b) disclosure must be provided.

Therefore, a combined notice is the most effective way to provide notice to satisfy both requirements.

Q: For real estate mortgage loans, if the settlement fee is not paid to the bank, the fee is not considered a finance charge, correct?

A: In general, a fee for attending or conducting a loan closing is a finance charge. According to Regulation Z's Official Interpretation 4(a)(2) Special Rule; Closing Agent Charges, this rule applies to charges by a third party serving as the closing agent for the particular loan. The regulation explains that fees charged by a third party that conducts the loan closing, such as the settlement agent, an attorney or escrow or title company, are finance charges only if the creditor requires the particular services for which the consumer is charged, requires the imposition of the charge, or retains a portion of the third-party charge, to the extent of the portion retained.

However, if an attorney charges for attending or conducting a closing, and the attorney does not separate the closing fee charge from his or her other charges, but bills the aggregate charge as a lump sum, then the closing fee may be excluded from the finance charge as long as it is "incidental" to the total charge. Because there is no definition for what is considered "incidental," it is a best practice to disclose the fee as a finance charge.

Q: We are in the process of creating advertisements for social media (Facebook). What information is required to be disclosed and what are the guidelines?

A: For any type of advertising on social media, you must follow the same disclosure rules based on deposits or loans as you would for any other Internet advertisement. You also need to maintain the documentation of the advertisements just like you do with your website. The "Member FDIC" tagline is used when advertising deposit products and when advertising the bank in general. ■

We recommend you refer to your specific state's statutes for requirements in your state.

COMPLIANCE HELPLINE AVAILABLE TO CLIENTS

Clients appreciate our Compliance Helpline, which is staffed by compliance professionals who have an average of 18 years of industry experience. These professionals respond to questions immediately, or within 24 hours if research is needed.

The Compliance Helpline can be reached Monday through Friday 8 a.m. – 5 p.m. at:

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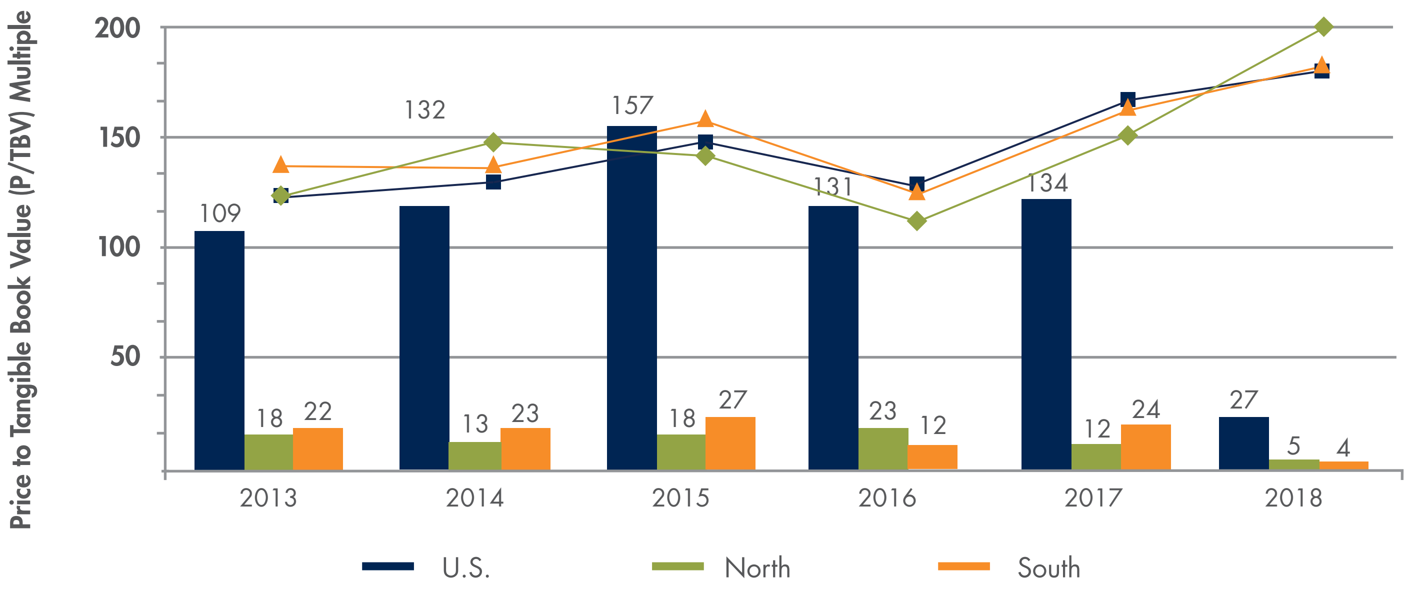
2018 Compliance Timeline

	Regulation	Description
April 19	Regulation Z Truth in Lending Act Mortgage Servicing	The Mortgage Servicing Rules relating to successors in interest and the provisions relating to periodic statements for borrowers in bankruptcy took effect.
May 11	Bank Secrecy Act – Beneficial Owners	The final rule requires institutions to adopt due diligence procedures to identify and verify a legal entity customer's beneficial owner(s) at the time a new account is opened. The rule also establishes a fifth "pillar" to which banks will be required to establish risk-based procedures for conducting ongoing customer due diligence, including the development of customer risk profiles and implementation of ongoing monitoring to identify and report suspicious activity and, on a risk basis, to update customer information.
June 1	Regulation Z Truth in Lending Act – TRID	The final rule addresses the use of closing disclosures to determine good faith disclosures of estimated closing costs.
	Regulation CC Availability of Funds and Collection of Checks	The amendments create a framework for electronic check collection and return and create new warranties for electronic checks, which will result in a consistent warranty chain regardless of the check's form. The amendments also modify the expeditious-return and notice of nonpayment requirements to create incentives for electronic presentment and return.

M&A Corner

The following data were compiled from information provided by S&P Global Market Intelligence. The data include all completed transactions reported with pricing information available for the time period January 1, 2013, through February 28, 2018. The data for the North category include all completed transactions reported with pricing information available in Idaho, Iowa, Minnesota, Montana, Nebraska, North Dakota, Oregon, South Dakota, Washington, Wisconsin and Wyoming. The data for the South category include all completed transactions reported with pricing information available in Arizona, Colorado, Kansas, Nevada, New Mexico, Oklahoma, Texas and Utah. The data did not include any government assisted transactions, branch acquisitions, or savings banks/thrift transactions.

Bank Transaction Data
U.S., North and South Regions
1/1/2013 – 2/28/2018



The bar graphs represent the number of transactions for which we have pricing data. In addition to the transactions summarized in the chart, there were 389 transactions in the U.S. since the beginning of 2013 for which pricing data was not included. Of those, 136 transactions were in the North region and 85 were in the South region.

	North	South
Geography	The transactions completed in 2018 were headquartered in Iowa, Minnesota, Montana, Nebraska, Washington and Wisconsin.*	The transactions completed in 2018 were headquartered in Colorado, Kansas and Texas.*
Target Size	Five of the 11 banks sold through February 2018 had assets less than $100 million, while one bank had assets greater than $1 billion.*	Four of the 11 banks sold through February 2018 had assets less than $100 million, while one bank had assets greater than $1 billion.*
Multiples	The average tangible book multiple through February 2018 was approximately 2.05, representing the highest average multiple from 2013 - 2018.	The average tangible book multiple through February 2018, of approximately 1.86, was slightly greater than the US average of 1.85 for the same time period.

**includes transactions for which pricing data was not available.*

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EIDE BAILLY WELCOMES HUSAR & JENNINGS INTO PARTNERSHIP

Shane Husar, Partner

Jeremy Jennings, Partner

On May 1, our firm welcomed 13 new partners and principals, including Shane Husar and Jeremy Jennings from our financial institutions group.

Husar is a partner in our Fargo, N.D., office. Husar helps our financial institution clients achieve their strategic business goals through his knowledge of the current regulatory environment and accounting requirements. He leads audit engagements for financial institutions with sizes ranging from $10 million to $8 billion in assets, as well as a variety of other services including internal audits, trust examinations, directors' exams, and loan file reviews.

Jennings is a partner in our Tulsa, Okla., office. Jennings specializes in providing business valuation services for estate and gift tax purposes, litigation, management planning and purchasing and selling businesses. He also provides economic damage calculations for business litigation and personal injury litigation. He works with financial institutions and other industries providing a broad range of services including assurance, tax compliance, tax planning and consulting for individuals, businesses, nonprofits and retirement plans.