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NON-INTEREST INCOME FOUND IN THE INSURANCE AISLE

BY JEFF CHESKY

In speaking to bank executives across the country as they conduct strategic planning for 2015, some of the most pressing topics include the growing burdens of regulatory oversight, expanding risks of competitive incursion and how to generate new sources of fee income. Fee income is my specialty, and from my perspective, is one of the most poorly understood topics in banking today.

A FRAMEWORK FOR UNDERSTANDING FEE INCOME

Simply put, fee income generation is an emerging science; more about identifying a customer's intentions rather than screaming for a customer's attention; more about adding value than extracting a penalty. All fee income is not the same.

Fee income can be segmented into two broad categories: dunning fees and value-added fees. For generations, banks have been experts at collecting dunning fees; late payments, NSF, wire transfers — the list is long. In this era of increased disclosure and transparency, politicians, regulators and consumer groups will continue to cap, reduce and eliminate these dunning fees.

Value-added fees are less meaningful to banks today, where the bank is paid a fee by a customer for helping that customer with something he or she wants or needs — loans to buy things, life insurance, investment products and foreign ATM availability. The future of banking will require a serious commitment to the emerging science of building and deploying value-added fee income generating strategies. One such strategy being employed more and more by community banks is insurance sales through a turnkey agency concept.

WHAT IS 'VALUE-ADDED' FEE INCOME?

As background, let's define this critical term. Value-added fee income can be defined against five measurable variables.

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- First, what percentage of your customers need or want the product you are thinking of selling that will generate the fee income;
- Second, how often do your customers need or want to buy these products — do your customers need to purchase this product once, occasionally or annually;
- Third, do these products generate 'one-time' or 'recurring' fee income, i.e., a mortgage loan origination fee vs. ongoing loan servicing fees;
- Fourth, do these products create any balance sheet risk, i.e., repayment, claims or warranty risk; and
- Finally, are these product purchases subject to changes in economic cycles, i.e., does a change in fed funds rate or unemployment impact purchase activity?

A growing number of bank CEOs are instructing their leadership teams to identify value-added fee income ideas that meet as many of these components as possible. The emerging gold standard for product positioning is to meet all five. Is that possible?

PREMIUM DIGITAL CONTENT:

A GOLD STANDARD EMERGES

In the words of Wells Fargo CEO John Stumpf at an investor conference in 2012, "The bank is in the market to buy insurance companies. A key reason: Wells is one of the largest originators of mortgages and used-car loans and those borrowers all need insurance." Stumpf has led the entrance into one of the first product suites that meet the gold standard for value-added fee income — auto and home insurance. Let's run the test.

- 100 percent of bank customers purchase auto and/or home insurance.
- 100 percent of customers repurchase these products every year.
- These products generate recurring/annuitizing revenue — average duration over six years.
- These products do not create balance sheet risk — the carriers pay any claims.
- These products are not impacted by economic cycles — even at the height of the great recession, people paid their insurance premiums.

FROM PRODUCT ORPHAN TO AN 'AISLE' IN THE STORE — CASE STUDIES

At Mid Penn Bank in Millersburg, Pa., CEO Rori Retrievi understood that the benefits of offering insurance weren't limited to the industry's largest banks. A community bank executive for over 20 years, he knew banks all had some insurance products kicking around on the platform: term life, credit life, ID theft etc. — but that they were typically orphans within the bank — no ownership, no commitment and no ongoing management. In fact, most bankers couldn't explain the "fee income" characteristics of these products. Rori jumped in and embraced the gold standard of insurance sales as an "aisle" in his store. He launched the Mid Penn Insurance Agency, stocked its shelves with the auto, home and commercial insurance products 100 percent of his customers buy every year, and over the last 12 months, 49 percent of the customers that Mid Penn Insurance Agency quoted, ended up buying a policy.

By offering a comprehensive suite of insurance products alongside its traditional banking products, Spencer County Bank in Santa Claus, Ind., has found that it can distinguish itself in the community as a "one-stop shop for financial products and services." As Merle Kendall, president and chairman of the bank noted, "Creating an 'insurance aisle' in our stores affords us the opportunity to provide a complete product offering and the technology to leverage our bank's lending opportunity and online banking opportunities." This value proposition has become increasingly important as several of the nation's largest insurance carriers continue to expand their retail banking and lending presence, evident in State Farm's recent "Borrow Better Banking" campaign. For Spencer County, which has insured nearly 1 percent of its retail households over the past 12 months, an "insurance aisle" not only represents an opportunity to grow fee income but also provides protection from competitors.

Finally, banks like Mid Penn and Spencer County are combining their commitment to offering insurance to customers with the same energy they do core banking products with the rapidly growing adoption and utilization of their online banking portal. By integrating their insurance aisle into their digital environment, they enable customers to have real-time access to the products they want and need, like auto, home and business insurance, AD&D, ID theft, roadside assistance and travel protection, and supplementing and replacing traditional third-party direct mail campaigns, statement stuffers, rack brochures and other outdated analog distribution methods. These innovative bank executives are proving that when their customers visit the bank online to pay bills or check balances, the bank can offer them additional value-added products and services, while also driving a critical source of non-interest income.

The pivot to understanding and embracing a new generation of products that generate value-added fee income is already under way. It's a true revolution for both the banks and their customers.

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STEPS TO A SUCCESSFUL MOBILE RDC PROGRAM

BY ROBB GAYNOR

Smartphones have transformed into more than just a means of communication as consumers become increasingly comfortable with their capabilities. One area in which this comfort has become most evident is in the dramatic growth of mobile banking usage: on average, 25 to 35 percent of a bank's customer base actively uses the mobile channel. What started out as a way to quickly check balances has evolved into full-service banking via the mobile device. The available features and clear demand from consumers has even led some institutions, such as Moven and BankMobile, to launch as mobile-only banks.

Growth in mobile banking functionality can partly be attributed to advances in smartphone cameras. Mobile remote deposit capture — the service that allows customers to take a picture of a check and deposit it via their mobile device — is one area that has benefited greatly from these camera advances. Checks may in general be going away, with decreasing volumes year-over-year, but there are many checks still out there and mobile check deposit is a critical part of a bank's digital strategy. In the feature's early history, it was more common for images to be declined due to poor quality, driving down customer satisfaction and usage. Image acceptance, however, has improved and with it, so has mobile RDC adoption.

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AND SO IT GROWS

Mobile RDC is one of the most impactful banking innovations in recent history due to the convenience it affords customers. They no longer need to physically visit a bank branch to deposit a check; instead, capturing the image through their mobile camera allows for quick, on-the-go banking, decreasing the time and money spent on travel to a physical branch.

It's no surprise that our usage data from 3.5 million monthly logins across 250,000 active mobile users shows a more than 50 percent increase in mobile RDC usage in the last 12 months. The statistics demonstrate a clear increase in awareness; it's not the average number of deposits per user that has grown, but the sheer number of users of the service. Typically 20 to 25 percent of a bank's active mobile banking customers are using mobile check deposit. The average deposit size is about $450 and customers are making an average of 2.75 deposits a month. Between July 2013 and June 2014, institutions that had been live with mobile RDC for 12 months saw a 45 percent increase in the number of checks deposited each month. Among our end-user base, mobile RDC ranks as the fifth most-used feature.

In addition, the Mobile Financial Services Tracking Study by Alix Partners found that 22 percent of smartphone/tablet owners are using the service compared to 18 percent in the first half of 2013. There is also seasonality related to the volumes around mobile check deposit; usage of this feature peaks during the holidays. In December 2013, volumes spiked by 25 percent as more checks flowed through the mobile channel. Interestingly enough, volumes went back to historical averages come January. This is potentially driven by the use of checks as gifts from family members.

IMPLEMENTING AN RDC PROGRAM

Mobile RDC has become ubiquitous; according to a 2014 survey by RemoteDepositCapture.com and Mitek, nearly 63 percent of U.S. banks offer it with 33 percent planning to do so within the next year, leaving those that don't in a tough competitive position.

However, some banks are still concerned with risk factors. There is the possibility that a customer could attempt to deposit a check twice, either by mistake or with fraudulent intent. While this is a risk, most RDC technology provides advanced duplicate detection that prevents an item from being deposited twice, or cashed in the branch after being deposited through the phone. In fact, according to the RemoteDepositCapture.com survey, 80 percent of financial institutions' mobile RDC services reported zero losses resulting from the technology.

The benefits of mobile remote deposit capture ultimately outweigh the risks that banks may face; lower transaction costs, improved teller efficiency, faster funds availability and meeting customer demand leave banks with no choice but to deploy the service if they haven't already.

There are several areas banks must focus on to ensure a successful mobile RDC program.

- Careful vendor selection is vital, but has also gotten easier as the number of reputable providers has increased. A vendor should be flexible in order to suit how your bank wants to deploy the technology and offer integrations with a wide range of check processors.
- Segmentation capabilities greatly enhance a mobile RDC program. Due to the potentially risky nature of the service, many banks place strict limitations on how it can be used. They may not allow customers to use the feature until they have had an account for three months or place tight limits on the dollar value that can be deposited to reduce potential losses. But with segmentation, instead of the bank applying strict rules across the board, they can be configured to specific customers. For example, while most customers are limited to $300 per item, perhaps higher asset account holders could have a more flexible limit.
- Mobile RDC programs can't be successful without marketing efforts that drive adoption. The first step is conducting in-app marketing that promotes the availability of RDC to current mobile banking customers. In-branch marketing material, website advertisements and a local ad campaign can make other account holders and prospective customers aware of the service. Always keep in mind that messaging should be consistent across all channels.
- Training customers on how to use mobile RDC is often overlooked, but is not only useful in driving adoption, but also in limiting issues for both the customer and the bank. One way to achieve this is to have tellers help customers open and use the feature in the branch using "fake" checks, or checks with a nominal value. Making customers comfortable with the service will increase usage. Points to emphasize are ways to capture a good quality image, as well as the need to sign the back of the check. Our data shows that 25 percent of the time a check is rejected, it is because the back of the check is un-signed.

We have reached a point where consumers expect to have RDC capability in their mobile apps. It provides a safe and easy option for bank customers who would prefer not to visit a physical branch each time they receive a check. Without mobile RDC, banks risk losing customers to the institutions that do offer it.

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MORTGAGE GIANTS OFFER 3 PERCENT DOWN PAYMENTS

Down payment requirements as low as 3 percent for qualified first-time homebuyers have been announced by Fannie Mae and Freddie Mac. The 97 percent loan-to-value ratio option will expand access to credit for qualified first-time homebuyers who may not have the resources for a larger down payment, Fannie Mae said. These loans will meet Fannie Mae's usual eligibility requirements, including underwriting, income documentation and risk-management standards. Private mortgage insurance or other risk sharing is required.

Homebuyers can now purchase a home under Fannie Mae's standard offering of its My Community Mortgage product with a 3 percent down payment if at least one co-borrower is a first-time buyer. In addition, eligible homeowners who wish to refinance their Fannie Mae-owned mortgage but do not qualify under the Home Affordable Refinance Program can refinance their loan up to the 97 percent LTV level under a limited cash-out option. Lenders must use Fannie Mae's Desktop Underwriter tool when evaluating mortgage applications for this product.

Fannie Mae has implemented prudent risk management practices to ensure that loans the company acquires are appropriately underwritten, including mortgages with lower down payments. These include essentially eliminating risk-layering on purchase money loans, requiring income documentation to avoid "low-doc" or "no-doc" lending and requiring income verification.

Freddie Mac launched its Home Possible Advantage, calling it an affordable conforming, conventional mortgage with a 3 percent down payment requirement designed to make responsible homeownership accessible to more first-time buyers and other qualified borrowers with limited down payment savings.

Home Possible Advantage offers qualified low- and moderate-income borrowers a conforming conventional mortgage with a maximum loan-to-value ratio of 97 percent and can be used to buy a single unit property or for a "no cash out" refinance of an existing mortgage. First-time homebuyers must participate in an acceptable borrower education program, like Freddie Mac's CreditSmart, to qualify for Home Possible Advantage and mortgages are available as 15-, 20- and 30-year fixed rate mortgages.

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'SMALL' AND 'INTERMEDIATE SMALL' BANKS DEFINED FOR CRA PURPOSES

Federal regulators announced the annual adjustment to the asset-size thresholds used to define small bank, small savings association, intermediate small bank and intermediate small savings association under the Community Reinvestment Act regulations.

Annual adjustments to these asset-size thresholds are based on the change in the average of the Consumer Price Index for Urban Wage Earners and Clerical Workers, not seasonally adjusted, for each 12-month period ending in November, with rounding to the nearest million.

As a result of the 1.6 percent increase in the CPI index for the period ending in November 2014, the definitions of small and intermediate small institutions for CRA examinations will change as follows:

"Small bank" or "small savings association" means an institution that, as of Dec. 31 of either of the prior two calendar years, had assets of less than $1.221 billion.

"Intermediate small bank" or "intermediate small savings association" means a small institution with assets of at least $305 million as of Dec. 31 of both of the prior two calendar years, and less than $1.221 billion as of Dec. 31 of either of the prior two calendar years.

These asset-size threshold adjustments were effective Jan. 1. The agencies will publish the adjustments in the *Federal Register*. In addition, the agencies will post a list of the current and historical asset-size thresholds on the website of the Federal Financial Institutions Examination Council, www.ffiec.gov/cra.

ABA Commercial Boosts Community Banks

SPOUSAL SIGNATURE PROVISIONS GET NEW EMPHASIS

BY PAUL J. CAMBRIDGE

The Equal Credit Opportunity Act and its implementing rule, Regulation B, prohibit any creditor from discriminating based on sex or marital status, among other protected statuses. All the federal banking agencies are involved in examining compliance with Regulation B; however, the Dodd-Frank Act transferred authority over implementation and interpretation from the Federal Reserve to the Consumer Financial Protection Bureau. Since the Dodd-Frank Act, we have seen a renewed emphasis on Regulation B during compliance examinations, and in many of these cases the primary issue has been violations of the spousal signature provisions.

MARITAL STATUS RULES UNDER REGULATION B

When an applicant applies for individual credit, a lender generally may not ask about the applicant's marital status. There are two exceptions to this rule: (1) if the credit transaction will be secured; or (2) if the applicant either resides in a community property state or supports the debt with assets located in a community property state. A lender is free to inquire about marital status when there is a request for joint credit, regardless of whether the credit will be secured or unsecured.

Regulation B provides that a lender may not require a signature of anyone other than an applicant or joint applicant if the applicant otherwise meets the lender's creditworthiness standards. However, third-party signatures may be required to the extent necessary to perfect a lien on jointly held property serving as collateral for a secured loan or, in the case of an unsecured loan, to allow the lender to reach jointly held property relied upon to satisfy the lender's creditworthiness standards. In addition, co-signors or guarantors can be required as necessary to meet the lender's standards.

An applicant's spouse may serve as an additional party, but requiring the spouse to be an additional party violates Regulation B. A loan officer may request support in the form of additional collateral or a guaranty, but the choice of guarantor must be left to the applicant. The loan officer should make clear that the spouse need not be the guarantor. If a borrower then offers his or her spouse to sign on to a loan, this decision should be documented in the loan file. Otherwise, when the loan is reviewed by an examiner, there will be no evidence to show that the bank did not require a spousal signature in violation of Regulation B.

Note that in business credit applications, a bank may require personal guarantees of those individuals with qualifying relationships to the entity, such as members of a limited liability company or directors of a closely held corporation. This right to require guarantees does not extend to a spouse of a person with a qualifying relationship to the borrower, unless the spouse has his or her own qualifying relationship. If additional support is needed to meet the lender's creditworthiness standards, a spousal guarantee may be provided at the borrower's option, but may not be required by the bank.

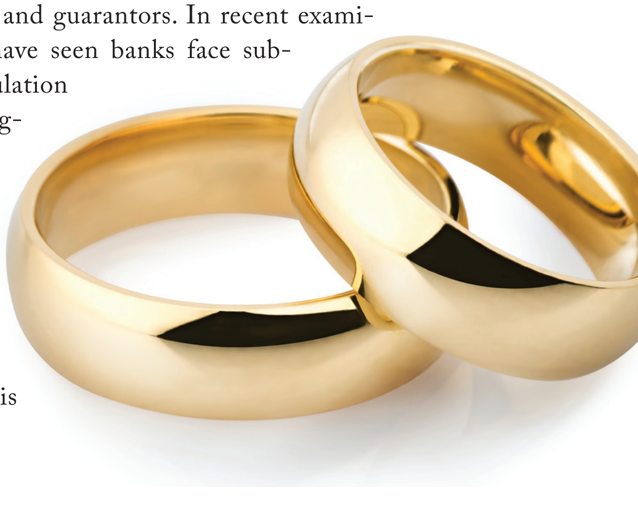
Given that the spousal signature requirements of Regulation B do not apply to joint applicants, this exception is often utilized by banks where two spouses will be parties to a loan. A person's intent to apply for joint credit must be appropriately evidenced at the time of application. The easiest way to document intent to apply for joint credit is to require an affirmative statement signed or initialed by the applicants stating they intend to apply for joint credit. This can be accomplished as part of a written loan application, as a stand-alone document, or as part of a joint financial statement. Signatures on a promissory note or submission of a joint financial statement without a specific affirmation of intent to apply for joint credit are not acceptable evidence under Regulation B. It is important to note that intent to apply for joint credit must be documented at the time of application for any extension of credit, including loan renewals.

SAME-SEX MARRIAGE UNDER REGULATION B

Per a June 2014 memorandum issued by CFPB Director Richard Cordray in response to the U.S. Supreme Court striking down Section 3 of the Defense of Marriage Act as unconstitutional, the CFPB has stated it intends to recognize same-sex marriages when interpreting Regulation B and other fair-lending regulations under CFPB jurisdiction. The CFPB will consider a person married nationwide if the marriage is legal in the state in which it was obtained. Domestic partnerships, civil unions or other relationships will not be included as marriage for Regulation B purposes. Based on this CFPB memorandum, it is clear that banks must extend the spousal signature protections of Regulation B to same-sex married couples even if the state in which the bank is located does not itself recognize same-sex marriage.

REGULATION B COMPLIANCE PROGRAM

If the regulators find that a bank violated Regulation B, the bank could be subject to enforcement actions, civil liability, lowered CRA ratings and lowered compliance ratings. In addition, examiners can require a bank to conduct extensive loan reviews to identify other issues, provide written advice of the violation to affected customers and release spouses as co-borrowers and guarantors. In recent examinations, we have seen banks face substantial Regulation B spousal signature issues even where the bank has a clean Regulation B compliance record. All it takes is



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one lender to inappropriately require spousal signatures or fail to adequately document Regulation B compliance to affect an entire bank.

To avoid Regulation B compliance issues among a bank's loan officers, the board of directors and officers should make compliance a priority by ensuring the bank has appropriate written Regulation B spousal signature procedures in place, either as part of the loan policy or as a stand-alone policy, and to provide adequate training and oversight of the lending staff. In addition, the use of a written affirmation of intent to apply for joint credit needs to be included as part of the application process and the lenders need to use it appropriately and have it signed at the time of application. Further, banks should be careful when obtaining spousal signatures as co-borrowers or guarantors, and only obtain them as necessary to meet creditworthiness standards. In situations where a spouse is not a joint applicant, the loan file must be clear that a spousal signature was offered by the borrower in response to a request for additional credit support.

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ADDRESSING THE PHILOSOPHICAL OBJECTION OF BOLI

BY JOHN GAGNON

Bank-owned life insurance has existed for nearly three decades and serves an important role in the banking industry as an efficient, tax-favored asset used to finance employee benefit programs. Currently, more than 57 percent of all U.S. banks own BOLI and more than 73 percent of U.S. banks with over $250 million in assets own BOLI. Total BOLI assets currently exceed $145 billion. In 2004, regulators issued interagency guidance (OCC 2004-56) providing banks a definitive roadmap to follow as to the purpose of BOLI and purchase instructions. This regulatory blessing was again affirmed in Dodd-Frank's Volcker Rule section in 2010. Given today's prevalence of BOLI and regulatory backing, objections to owning this popular asset still exist.

Objections to owning BOLI are puzzling given its merits. BOLI has an extensive track record of outperforming similar bank-eligible investments such as municipal bonds, U.S. Treasuries and mortgage-backed securities. The credit quality of most BOLI is excellent, as insurance carriers offering the product are generally rated highly by agencies such as S&P, Moody's and A.M. Best. BOLI offers investment diversification and a consistent, non-volatile return while potentially mitigating interest rate risk. The administration and accounting of BOLI are also simple and straightforward. The cash surrender value is booked as an "other asset" and the period-to-period increase in cash surrender value is recorded as "other non-interest income."

The general objections to BOLI are typically either based on the perception of BOLI's liquidity or are philosophical in nature. Banks that are concerned with liquidity usually have current strong loan demand or have strategic plans to utilize its capital for branch expansion or acquisition goals. To maximize return, BOLI is intended to be held long-term as BOLI gains are tax deferred (tax-free if held until death). Banks are reluctant to surrender BOLI as gains are subject to income tax and a 10 percent excise tax. A surrender analysis should be completed prior to a BOLI purchase to determine if BOLI is still a good investment if the bank ultimately has liquidity needs and must surrender. This analysis typically demonstrates BOLI having an incremental return to other available investments even upon early surrender. However, if the bank has liquidity issues or their strategic plans require greater liquidity, it might be reluctant to invest in BOLI.

The more pervasive objection to BOLI is philosophical in nature and generally relates to the discomfort of receiving death benefit payments on the lives of current or former employees. This creates a misconception that the bank is profiting on the death of an executive. While reputation risk must be considered, a proper understanding of BOLI is warranted. It is designed as an institutional product, providing maximum cash value and minimal excess death benefit but there still needs to be an amount at risk to the insurance carrier so that it qualifies as life insurance and retains its tax-favored attributes. OCC 2004-56 Interagency Guidance states, "Life insurance holdings can serve a number of appropriate business purposes. Because the cash flows from a BOLI policy are generally income tax-free if the institution holds the policy for its full term, BOLI can provide attractive tax-equivalent yields to help offset the rapidly rising cost of providing employee benefits."

BOLI providers also adhere to COLI Best Practices, codified in the Pension Protection Act of 2006. This requires positive written consent of all individuals being insured, may insure only highly compensated employees and coverage is limited to key persons (management or officer level). Employees uncomfortable being insured can simply decline to consent to be insured, which occurs occasionally. Most banks explain to employees that the BOLI program in which they are being asked to participate is designed to accomplish three objectives:

First, BOLI helps the bank increase earnings in order to offset either a specific benefit program the employee is participating in or overall annual increases in employee benefit programs such as health insurance or pension cost. Second, BOLI provides key person life insurance coverage in the event of a key employee's untimely death. This benefit reimburses the bank for lost skills and knowledge and helps to fund the search and replacement cost of finding new executives. Many banks undervalue the fiscal impact of losing an experienced executive. Third, BOLI may provide a death benefit payment to the insured employee's named beneficiary.

> **AS AN INSURED UNDER A BOLI PROGRAM, EXECUTIVES SHOULD UNDERSTAND THAT ULTIMATELY THE BANK WILL RECEIVE A DEATH BENEFIT PAYMENT ON THEIR LIFE. THEY SHOULD ALSO UNDERSTAND THAT THIS ALLOWS THE BANK TO INCREASE PROFITABILITY, BENEFITING ALL EMPLOYEES VIA PROFIT SHARING OR EXPANDED BENEFITS.**

A bank has the choice of whether or not to share a portion of the death benefit with the executive. If a bank opts to share a portion of the death benefit, it must decide whether to provide this benefit exclusively during employment or to extend the benefit into retirement. If the bank provides the benefit postretirement it must accrue an expense for the postretire-ment death benefit liability according to accounting rules (ASC 715). Due to this expense, it is typical for a bank to pro¬vide shared death benefits only while the insured individual is employed in order to maximize the incremental income to the bank's bottom line thus accomplishing BOLI's objective to effectively offset employee benefit costs.

As an insured under a BOLI program, executives should understand that ultimately the bank will receive a death benefit payment on their life. They should also understand that this allows the bank to increase profitability, benefiting all employees via profit sharing or expanded benefits. Most executives recognize this trade-off and are willing participants in a properly designed BOLI program.

The fact that the bank can choose to only share death benefits during employment, or not share any death benefit at all, contributes to the philosophical objection some banks and bank boards have with BOLI. However, fundamentally, BOLI's death benefits result from years of investment gains on the policies which were implemented to finance the bank's employee benefit costs. The death benefit proceeds are part of the overall financing strategy, ultimately providing the bank with recovery of costs incurred.

Banks that object to BOLI still have employee benefit costs that must be paid and an alternative asset or investment must be employed to offset those costs. BOLI offers a more effective asset that allows banks to free up resources to expend on other important objectives such as additional loans, growth via expansion or acquisition, reinvestment into the community under the Community Reinvestment Act or expanded shareholder dividends.

John Gagnon co-founded GW Financial, a company that assists corporations, banks and individuals in establishing and implementing retirement programs and insurance investments. He is a registered representative with M Holdings Securities Inc. For more information visit www.bolicoli.com.

BEWARE THE CFPB'S HAZARDOUS CIVIL INVESTIGATIVE DEMAND

BY DYLAN W. HOWARD

Banks continue to adapt to life with the Consumer Financial Protection Bureau, which has ushered in an era of substantial regulatory changes, the threat of civil suits, fines and restitution orders. Although the CFPB lacks authority to bring a criminal action, it may refer complaints it believes to be criminal to the local U.S. district attorney for prosecution.

In establishing the CFPB, Congress opted to give it wide-reaching authority to investigate potential violations of the law. Specifically, the Dodd-Frank Act provided the bureau with authority to issue a civil investigative demand, or CID, where it has reason to believe any person may be in possession of a document or information relevant to a violation. The CID may require the production of documents or tangible items, the submission of written responses to requests for information, and the scheduling of an actual deposition.

Responding to a CID is an art unto itself, and one that must be performed rapidly under often adverse conditions. As soon as a CID is served, the recipient should issue an order to its employees requiring the preservation of any documents potentially relevant to the CID. Next, the recipient must develop a response plan, ideally working closely with competent legal counsel within a day or two of receiving the demand. The decisions made in the first few days following service are critical, as the recipient of the CID must "meet and confer" with CFPB representatives within 10 days of service of the CID.

At that initial meeting, the recipient will not only need to have an understanding of the CFPB's concerns with regard to the recipient's conduct, it will need to have a good grasp on the responsive information and documents it possesses. It must also be in a position to raise any objections to the scope or the specifics of the CID. The latter issue is mandatory. The CFPB's position is that it will not consider petitions to set aside or modify a CID unless the recipient raised the issues during the initial meeting.

If the recipient has objections to the scope or the specific documents, information or testimony sought in the CID, it must be prepared to act quickly. The recipient has 20 days from service of the CID to file a petition seeking to amend it or set it aside. There is no provision for filing a brief, place-holder petition to reserve objections. The petition to set aside must include all factual and legal objections to the CID and must further contain any affidavit or other necessary documentation or evidence supporting the recipient's objections.

Obviously, this is a substantial hurdle. A recipient may request an extension of these deadlines, but the decision to grant or deny the request is within the sole discretion of the CFPB and current regulations explicitly disfavor the granting of such requests.

In other circumstances, the decision to file a petition to set aside or amend might be considered an obvious strategy to be used liberally. With the CFPB, the decision is substantially more difficult as a result of one troubling consequence. According to the bureau, its investigations are considered private in their early stages. The CFPB has announced, however, that once a petition to amend or set aside is filed, the investigation becomes public.

This presents the recipient of the CID with a very difficult decision. It must either waive its rights to object to what are often very broad CIDs seeking the production of otherwise confidential information that often spans thousands of customers over multiple years. Or, the recipient may reserve its rights and raise its legal objections, but face public scrutiny and potential reputation loss.

Recipients may request confidential treatment of a petition to amend or set aside a CID, but attempts to do so in the past have not been productive. In a 2012 decision, the CFPB declined a request by two companies for confidential treatment and for advance notice of a decision to disclose the existence of the investigation. The bureau held, in its complete discretion of course, that the companies failed to demonstrate "good cause" for confidential treatment. The companies had asked to withhold information including but not limited to their names, the existence of the investigation and their corporate documents including articles of incorporation. The CFPB indicated that it might agree to keep information confidential when the information included privileged commercial or financial information obtained from a person or individual; or where the information sought would cause substantial harm to the recipient's competitive position, which could be caused by the disclosure of specific business, strategy or operational plans or structures.

Obviously, the mere identity of the recipients, the existence of the investigation or general corporate documents would not meet this high standard. As a result, recipients must anticipate that any motion to set aside or amend a CID will make the investigation public.

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Financial institutions responding to a CID have little reason to be optimistic about the result of a petition to set aside or amend it. The director of the CFPB reviews, evaluates and rules on all such petitions. The CFPB has announced that it will uphold any CID where the director concludes that the information sought is relevant to an authorized investigation and the procedural requirements have been followed. Of the 10 petitions to set aside for which the CFPB has published a ruling on its website to date, none have been granted.

Finally, if a recipient is unable to comply with the CID in a satisfactory manner, the CFPB can bring a lawsuit in federal court to enforce compliance. At that point, a recipient would need to show both a good faith effort to comply with the CID and a persuasive reason for non-compliance.

Because of these hurdles, the goal for the vast majority of financial institutions served with a CID should be satisfying the CFPB while limiting the extent of the disclosure. The best opportunity to attain this goal is at the initial meet and confer meeting. As a result, the recipient needs to engage competent legal counsel immediately and to work with counsel to develop a holistic response plan.

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AGRICULTURE IS HEALTHY BUT CAUTION IS URGED

BY BILL POQUETTE, EDITOR-IN-CHIEF

A clear message from the American Bankers Association's National Agricultural Bankers Conference in Omaha recently was that "now is a great time to be in agriculture." However, with that message came a cloud over 2015, formed by sagging crop prices and rising input costs. A variety of speakers from academia and the agricultural and banking industries did a good job of validating the cheerful long-term outlook and suggesting financial management tools to cope with volatile commodity prices and rising farm operating expenses in the near term.

The conference opened with Lowell Catlett, regent's professor dean of the College of Agricultural, Consumer and Environmental Sciences at New Mexico State University, predicting that as incomes rise in the United States and around the world, so will demand for meat protein.

"When people have money, they change their eating habits," he said. "Number one for growth is meat protein, and the U.S. and Canada will supply it."

Income growth in developing countries will be a catalyst, he noted. And just in this country, baby boomers will be passing on the greatest ever transfer of wealth in a few years. Generation Xers are the best-paid generation ever, he added.

Catlett's view was confirmed in another session conducted by Jason Henderson, associate dean and director of Purdue University Extension, and Brent Gloy, farmer and co-founder of Agricultural Economic Insights.

They displayed data from the International Monetary Fund showing that populations will rise steadily in emerging and developing countries through 2019, as will their share of world gross domestic product based on purchasing power. And Purdue's Center for Commercial Agriculture has tracked rapidly rising animal protein as a percent of total protein in developing countries from 2005-2007. The data on population and income provide potential opportunities for North American agriculture, according to Henderson and Gloy.

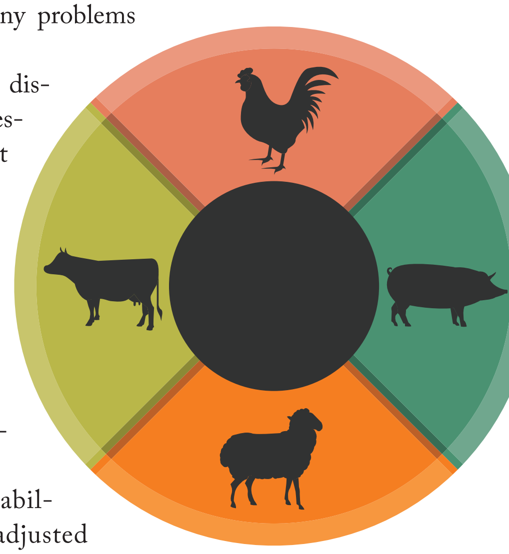
In the near term, however, 2015 looks "downright ugly," according to Gloy. Past cycles suggest a five-year slump in corn prices and a similar path for other crops, he noted. And with slumping prices and rising variable costs, crop insurance no longer guarantees a comfortable contribution, he added.

The colleagues suggested that options in the new farm bill provide good timing for 2015 operating line repayment next fall. There is a lot of uncertainty they pointed out, over which option to choose and how much to expect.

Farmers and their lenders shouldn't count on big declines in variable costs, they advised, if history is any guide. Cash rents haven't gone down very often in the past as well, but some relief might emerge this time around. And among other variable costs, family living expenses have increased substantially. Rising farm debt is another concern of Henderson and Gloy. "Debt is being accumulated," said Gloy. "Be very watchful of how much debt is going into real estate."

The pair concluded their session with some advice for bankers: enjoy a chance to earn interest income; earn it by really managing credit rick; stick to sound underwriting principles; do not buy into inflationary real estate gains; get customers to understand financial statements; demand sound risk management plans; and get customers to lower costs.

This year will be OK for most, but prepare for tougher sledding in 2015, they suggested. Good managers will be very successful in their view, but marginal credits can quickly become problem credits in the current environment. "Make sure your staff is ready to capitalize on the opportunities that will be available and deal with any problems that arise," they said.



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Similar advice was dispensed in a workshop session titled "Repayment Risk in a Variable Price Environment." Freddie Barnard, agricultural economics professor at Purdue University, provided 10 keys to reducing that risk:

- Do not abandon proven credit standards.
- Focus on profitability using accrual-adjusted financial statements.
- Beware of the "wealth effect" — the purchase of capital assets when profits and repayment capacity are declining.
- Understand and respect the impact of increased leverage on repayment capacity.
- Manage interest rate risk by locking in low rates.
- Reduce production risk with crop insurance.
- Reduce market risk with a disciplined marketing plan.
- Pay attention to working capital "burn" and increase working capitaI to gross revenue for more highly leveraged borrowers.
- Get guarantees on questionable loans.
- Use the financial tools available and conduct sensitivity analysis or stress testing on revenue, expense and interest rates, working capital and asset value declines.

In the same session David Kohl, professor emeritus of agricultural and applied economics at Virginia Tech, suggested using software for a "dashboard" approach that "makes the numbers talk to bank customers."

He focused on the working capital burn rate. Determine the minimum burn rate of working capital with debt service, he advised, and determine it with negative margin. He flashed a green light to a burn rate of more than 3.5 years; yellow from one to 3.5 years; and red for less than one year.

Kohl suggested a five-step process to positive margins: increase business revenue, increase non-business revenue, reduce expenses, reduce family living expenses and taxes, and restructure debt.

ADVICE FOR BANKERS INCLUDES: ENJOY A CHANCE TO EARN INTEREST INCOME; EARN IT BY REALLY MANAGING CREDIT RICK; STICK TO SOUND UNDERWRITING PRINCIPLES; DO NOT BUY INTO INFLATIONARY REAL ESTATE GAINS; GET CUSTOMERS TO UNDERSTAND FINANCIAL STATEMENTS; DEMAND SOUND RISK MANAGEMENT PLANS; AND GET CUSTOMERS TO LOWER COSTS.

SECOND-QUARTER CREDIT CARD GROWTH OFFSETS EARLIER DECLINE

The U.S. credit card market bounced back in the second quarter as the economy improved, according to the American Bankers Association's December 2014 Credit Card Market Monitor report. The number of new accounts increased and monthly purchase volumes picked up, while the distribution of accounts resumed its shift away from "revolvers" who carry balances month-to-month.

The report found that monthly purchase volumes also resumed their longer-term growth across all customer risk profiles in the second quarter. Compared to the first quarter, monthly purchase volumes rose 14.3 percent for sub-prime accounts, 10.3 percent for prime accounts and 8.2 percent for super-prime accounts. This rebound is consistent with an improving consumer picture; retail sales saw consistent gains throughout the quarter and consumer spending picked up significantly. Similarly, the number of new accounts increased across all risk categories, with new account volumes now up 10 percent year-over-year.

"Strong economic growth in the second quarter offset declines in the first quarter," said Molly Wilkinson, executive director of ABA's Card Policy Council. "The significant economic growth we've seen in recent months makes it likely that credit card market trends will continue for the remainder of 2014 and beyond."

The distribution of accounts across activity types resumed its trend toward "transactors" in the second quarter, a departure from the previous two quarters in which the share of revolvers increased. Among all account holders, the share of transactors — those who pay their balance in full instead of carrying a balance forward — increased 0.6 percentage points to 29 percent, while dormant accounts increased 0.8 percentage points to 29.8 percent. Although still representing the largest share of accounts, revolvers fell 1.5 percentage points to 41.2 percent.

The shift away from revolvers reflects a changing consumer marketplace," Wilkinson said. "More and more consumers are using their credit card as a payment tool rather than a form of debt."

The report also found that the average credit line for new accounts (open less than 24 months) ticked up slightly for sub-prime and prime accounts (up 0.1 percent and 0.2 percent respectively), and increased moderately for super-prime accounts (up 1.2 percent). When all accounts are included, average credit lines declined across all risk types, although at a slower pace than in the previous quarter.

"As the economy improves, consumers are better able to meet their financial obligations," Wilkinson said. "This is reflected in the small credit line increase for new accounts as lenders gain confidence in consumers' ability to manage their household debt."

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