the COMMUNITY BANKER UPDATE

JANUARY 2016

OFFICIAL PUBLICATION OF THE COMMUNITY BANKERS OF IOWA

Happy New Year

JANUARY 2016 WEBINAR LINE-UP

Jan. 5	New Unauthorized ACH Rules: Impact on Return Rates & Fee Thresholds
Jan. 7	Record Retention & Destruction Rules: Electronic & Paper
Jan. 12	Avoiding Compliance Violations in Advertising
Jan. 13	Debt Collection Series: The Essentials of Collection Law
Jan. 14	Cyber Series: Maximizing Cyber Security Soundness & Minimizing Incidents
Jan. 20	IRA & HSA Update & Review 2016
Jan. 21	Adjustable Rate Mortgage (ARM) Rule Changes Effective April 1, 2016
Jan. 26	Demystifying Rules for TRID Tolerances
Jan. 27	Completing the CTR Line-by-Line
Jan. 28	Director Series: Managing Reports to the Board: Requirements, Timing, Delivery Options, Risks & Concerns

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In This Issue

CBI Community Bankers of Iowa

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Welcome New CBI Members!

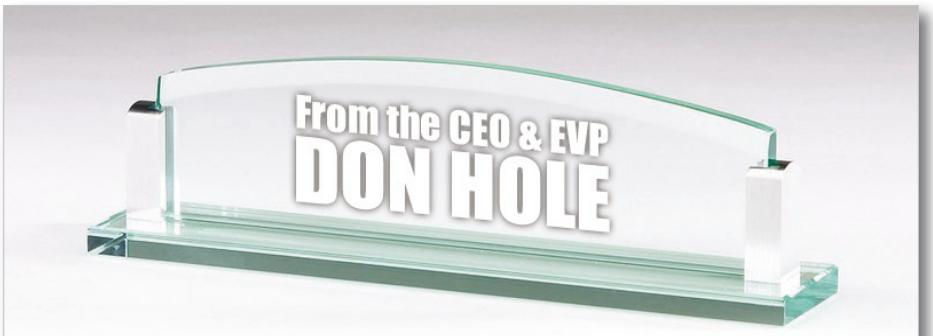
The Community Bankers of Iowa would like to welcome the following companies to the association, and thank them for their support:

Atris Technology

Corporate Contracts

FIPCO

Mattan Pratt Consulting



New Year's Resolutions for Community Bankers

It's that time of year when we all feel compelled to adjust our attitudes and begin anew; believing that by refocusing our resolve and efforts it will result in significantly improved outcomes. It is in that light, that I propose the following New Year's resolutions for community bankers across the state. Perhaps one or more may prove useful.

I RESOLVE to spend some time making sure that compliance has not consumed ALL the oxygen in my bank. Important areas like marketing, customer service, product management, employee motivation and rewards, expense control and operational improvement all can and do pay dividends if managed well.

I RESOLVE to remind my community of all the benefits for them of having a community bank serving them by publicly demonstrating our commitment during Community Banking Month in April. Officers cleaning windshields in the drive up, public celebrations and meals, visible community support events and programs can all be effective with a little effort and also be fun for the bank and community.

I RESOLVE to support through membership, PAC support and active advocacy, CBI and ICBA who work tirelessly to defend the community bank model on a state and national have exempted community banks from a myriad of burdensome regulations like Fed dividend cuts, redundant privacy notices, expanded examination cycles, restores cuts in crop insurance programs and many more.

I RESOLVE to consider the products and services provided by CBI as alternatives to what my bank may be using, to increase effectiveness and/or reduce costs for my bank even if a change may be required to do so knowing that there are not only benefits for my bank, but also for my associations ability to advocate on my behalf.

I RESOLVE to educate my staff on functional areas and provide appropriate developmental and networking experiences to assure a capable talent pool for the future of my bank.

I RESOLVE to improve my banks network by attending the CBI Annual Management Conference and Convention July 13-15 in Okoboji to refresh my spirit and enthusiasm by networking with community bankers from across the state, learning from national quality speakers and dedicated business partners and by sending staff members to available CBI networking opportunities like LOT, Community Bank Summits and the State Fair Conference.

I RESOLVE to remain optimistic and enthusiastic throughout 2016 and work hard to make sure that my bank is fulfilling its mission to support and enhance our communities, customers and shareholders.

Happy New Year!

What We Stand For:

2016 CBI Policy Issues

The 86th Iowa General Assembly will officially begin on January 11, 2016. As we near the start of a new legislative session it is fitting to review what exactly the Community Bankers of Iowa stands and advocates for on The Hill, both in Iowa and Washington D.C.

CBI is focused on exclusively representing Iowa's community banks and bankers. Below are the current policy resolutions CBI supports and advocates for on behalf of Iowa's independent, community banks and bankers.

State Issues

1. CBI continues to support beneficial and fair competition among insured depository institutions through active enforcement of Iowa's laws relating to multi-bank holding company deposit concentration and CBI will remain active in any ongoing dialogue to ensure that existing limitations remain and enforceability continues.

2. CBI supports parity for Iowa-based financial institutions with out-of-state entities.

3. CBI supports the right of individual states to regulate financial institutions within their borders, regardless of charter source and selection. As a result, CBI opposes blanket preemption of state laws designed to protect the welfare of Iowa's citizens by any federal agency or regulator and supports legislation or regulations that defer to state-established minimum standards over federally-established minimum standards for Iowa financial institutions.

4. CBI supports legislation designed to provide parity to Iowa banks in cases where federally chartered banks have privileges or permissible activities not allowed to state chartered banks to better enable Iowa chartered banks to remain competitive and thereby better able to serve Iowa consumers.

5. CBI supports state policies that strengthen, diversify, and promote adding value to Iowa's agricultural production including alternative fuel and energy production.

6. Should weather conditions in Iowa negatively impact the agricultural industry, CBI supports emergency relief efforts at both the State and Federal level that will help provide the industry with the liquidity that may potentially be needed for farms to survive, including programs that may be offered through financial institutions designed for such purpose.

7. CBI supports policies that will result in broad infrastructure investment and long-term funding of Iowa's roads, bridges, and railways so that Iowa's products can continue to reach markets and Iowa's general economic growth in both rural and urban areas can be optimized.

8. CBI supports conforming the provisions of the Iowa Banking Code to the Iowa Business Code.

9. CBI supports legislation and local efforts to enhance chances for Iowa communities to benefit from the rural development incentives provided under Title VI of the Farm Security and Rural Investment Act of 2002.

10. CBI supports amending the Iowa Code to clarify that agricultural supply dealer liens only may achieve priority over prior perfected liens only with the written consent of the prior secured creditor.

11. CBI supports the parity of taxation between credit unions and community banks.

12. CBI is opposed to any state efforts to expand credit unions' field of membership or permissible activities beyond those consistent with the traditional mission of credit unions.

13. CBI is opposed to additional regulatory or statutory burdens or restrictions on agency brokerage by banks or bankers of insurance, real estate and securities.

14. CBI continues to support legislation that would allow title insurance to be sold privately in Iowa.

15. CBI supports a state tax credit for fees paid to the SBA for loan origination within Iowa.

16. CBI supports allowing Iowa-chartered financial institutions with trust powers (or that amend their charters to provide for trust powers) to transfer trust activities to a separately established affiliate owned by their parent holding company or the financial institution itself.

17. CBI encourages the Governor, the Legislature and Iowa Department of Economic Advancement to develop programs to specifically address smaller communities and small business development along with larger target industry programs.

18. CBI supports the ability of all cardholders of financial institutions in Iowa to have universal access to all ATMs located in Iowa as has been our law and practice since 1972.

19. CBI supports pursuing legislation or regulation to provide that any statutory superiority lien granted to the Iowa Attorney General, by way of Receivership pursuant to 249A.44, also include appropriate due process protections, adequate notice to all impacted parties, and a procedure for equitable allocation by a Receiver of any such lien among all of the parties involved in the proceedings.

20. CBI supports legislation that would allow the Iowa Department of Banking to examine and, when appropriate, engage in enforcement actions against third party vendors to banks that could create cyber-risks to the bank or its customers.

21. CBI supports efforts at the state level to enhance prosecutorial powers and enforcement actions against and jurisdiction over those engaged in cyber-thefts or hacking.

22. CBI supports consistent state regulation of virtual currency activities, such as the Policy and Framework developed by the Conference of State Bank Supervisors.

23. CBI supports legislation to make retailers and merchants liable for data breach and fraud losses incurred by banks due to the action or inaction of the retailers/merchants.

24. CBI supports legislation giving the Superintendent of Banking authority to issue parity orders to ensure fair and equitable treatment of state-chartered banks as compared to other financial institutions.

25. CBI encourages the Iowa Division of Banking to streamline and amend Chapter 524 to reduce unnecessary regulations and revise provisions which are inconsistent with modern corporate authority.

Federal Issues

1. CBI supports federal legislation to further expand favorable community bank tax treatment so they can compete with other financial institutions (e.g., credit unions) serving similar markets.

2. CBI opposes any federal legislation that would expand credit unions' field of membership or permissible activities beyond those consistent with the traditional mission of credit unions.

3. CBI opposes the burdensome provisions of the Basel III capital rules relating to various reporting requirements, while generally supporting application of portions of Basel III as it relates to capital levels that are uniformly imposed on all banks.

4. CBI supports legislation that would require "Too Big to Fail" banks to hold tangible capital commensurate with their risk activities and profile.

5. CBI supports the ICBA "Plan for Prosperity" as a set of provisions to help preserve the community banking model and way of life.

6. CBI supports a true, bifurcated regulatory system that does not impose some of the burdens on banks with assets over $10 billion that were aimed at addressing their past practices onto community banks. Community banks should not be burdened with rules and standards designed for the larger banks that make it more difficult for smaller banks to remain profitable, stay in business and serve their communities.

7. CBI continues to support increasing the number of eligible shareholders in order to qualify for S-Corporation status from 100 to a more appropriate number.

8. CBI supports prudent tax provisions such as Congressional efforts to extend certain tax cuts.

9. CBI supports permanent elimination of federal estate taxes as a means of preserving family farms and businesses.

10. CBI opposes new or increased fees or taxes on community banks including increases in examination fees and taxes on bank products or any changes that would increase their tax liability.

11. CBI supports continued federal efforts to provide financial education to consumers and students in efforts to promote informed consumer financial decisions and efforts to assist community banks in helping consumers understand financial products and decisions.

12. CBI opposes the affiliation of commercial banks or bank holding companies with commercial firms, including using limited purpose charters outside current regulatory frameworks in order to create competing, parallel banking structures.

13. CBI supports including the Farm Credit System in the proposed review of GSEs Fannie Mae and Freddie Mac.

14. CBI supports regulatory and tax relief that is broad based in order to give community banks better opportunities to fulfill their responsibilities to their communities and compete fairly with tax-advantaged entities including credit unions and the Farm Credit System.

15. CBI opposes any CFPB-imposed regulatory burdens on community banks or being subjected, directly or indirectly, to CFPB's regulation and enforcement powers and specifically opposes any "mission creep" on the part of CFPB.

16. Recognizing the importance of the farm sector's profitability, we support efforts to enhance crop insurance product offerings to provide an effective financial safety net.

17. CBI opposes unfair competition from federal GSE's by the implementation of statutory language providing that the obligations

(***2016 CBI Policy Issues*** *continued on next page)*

(***2016 CBI Policy Issues*** *continued from previous page)*

of such entities are not backed by the full faith and credit of the United States.

18. CBI supports the increase in FDIC insurance limits but believes such limits should be indexed to keep pace with inflation.

19. CBI opposes legislation that would make financial institutions liable for repayment of any authorized distributions of government benefits from deceased accountholder's accounts until such time as financial institutions have received actual notice of the accountholder's death from the accountholder's estate.

20. CBI supports fair privacy legislation that contains uniform standards for all insured institutions and would resist any efforts to require additional or added opt-in or restrictions on information sharing with affiliates.

21. CBI supports payment system regulation that preserves the ability of community banks to compete fairly in the traditional payment system mechanisms as well as ATM, debit, credit card, POS, mobile, and other evolving electronic payment systems and that recognizes community banks are not in a position to bear responsibility for oversight of service providers beyond conducting reasonable due diligence in connection with evaluating potential vendors

22. CBI opposes the sale of bank customer data to unrelated third parties on grounds of bank customer confidentiality, while supporting the ability of banks to share information with contracted third parties in the delivery of additional customer services.

23. CBI supports adoption of regulations to address "Too Big to Fail" institutions for a number of reasons, including the risk such institutions pose to the FDIC's insurance fund and the potential assessments community banks could face to cover resolution costs for such institutions.

24. CBI supports the Independent Community Bankers of America's Priority Resolutions.

25. CBI opposes using FDIC deposit insurance funds for any non-financial institution bailouts and extending FDIC insurance coverage to any non-financial institutions.

26. CBI encourages legislation that would prohibit retailers from discriminating against community banks or any products or services offered by community banks or steering customers away from them.

27. CBI supports playing field-leveling legislation to allow insured institutions to compete with non-insured institutions.

28. CBI supports making the NOL five-year carryback permanent for all community banks.

29. CBI supports the ability of community banks, through thoughtful, fair, legislation and regulation, to offer a variety of overdraft services and will continue keeping their consumers fully-informed per applicable requirements of their overdraft coverage's and the cost and benefits of such coverage's.

30. CBI supports addressing regulatory burdens through shared consortium opportunities, such as compliance and core processing, through jointly owned service corporations or subsidiaries with shared management for their operations and oversight of vendors and compliance efforts.

31. CBI supports exemption for community banks from any additional OTC derivatives regulation (including clearing and capital requirements) where such derivatives are used as a tool for hedging risk.

32. CBI supports enforcement of a hard deposit concentration cap that is not vulnerable to manipulation.

33. CBI supports legislation and regulation that establishes realistic valuation metrics for purposes of credit analysis.

34. CBI supports allowing community banks, through legislative initiatives, to amortize commercial real estate and commercial real estate loan losses over a 10-year period.

35. CBI supports repeal of portions of Dodd-Frank as applied to community banks that should only be applied to large banks, while also supporting the continued implementation of the Act and its regulatory mandates so long as regulators and legislators are cognizant and sensitive to the unique nature of community banks and the burden and competitive inequity that results from added regulatory burdens.

CBI's Advocacy Center has information on the latest community banking issues, and you can send customized letters to your legislators. Visit cbiaonline.org/cbiicba-advocacy-center.html. If you have any questions about CBI's policy resolutions, please contact us at 515.453.1495.

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Submit your request at cbiaonline.org/cbi-speakers-bureau.html. The Guide will be emailed to you, in Excel spreadsheet format (sorry, we cannot provide the Guide in any other format).

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Development and Maintenance of an EFFECTIVE LOAN POLICY - Pt. 3*

by James L. Adams, Supervising Examiner
Federal Reserve Bank of Philadelphia

Parts 1 & 2 of this article were originally published in the May 2015 and June 2015 issues of Community Banker Update. Find them at cbiaonline.org/community-banker-update-archive.html

This article touches on post-origination risk management activities and tools that examiners will normally find in an effective bank loan policy: a risk rating system; a monitoring framework; management information systems (MIS) and reporting; internal controls, including audit, loan review, and credit administration; and a problem loan workout function. Although maintaining an appropriate allowance for loan and lease losses (ALLL) is also a key component of post-origination risk management, much guidance and numerous articles have been written on the topic; therefore, it will not be covered in this article.[1]

As mentioned in the prior articles in this series, processes and procedures that govern lending activities do not necessarily need to be incorporated within one single loan policy; however, a bank should maintain a central repository that houses all relevant policies to promote consistent application by its employees.

Risk Rating System

A key element of a sound monitoring framework is a well-defined and adequately documented risk rating system. The importance of risk ratings was discussed in part two of this series, noting that the bank should have a process to assign accurate and timely risk ratings and to update ratings when appropriate. While the granularity of risk rating systems can vary significantly based on portfolio size, composition, and product complexity, management should ensure that risk ratings are accurate and reliable. Ineffective risk ratings systems will result in weak portfolio oversight, an inaccurate ALLL, and ultimately, increased credit losses.

An effective risk rating system should:

- Provide the foundation for credit risk measurement, monitoring, and reporting
- Support management and board decision-making
- Be sufficiently flexible to allow for use with various types of credit exposure
- Provide appropriate granularity of risk ratings (including regulatory classification grades) that accurately reflect the risk of default and credit losses
- Offer multiple pass grade options as appropriate for the complexity and risk of the portfolio that adequately differentiate pass risk ratings
- Precisely define ratings criteria using both objective (quantitative) and subjective (qualitative) factors
- Consider both the borrower's expected performance and the transaction structure
- Be independently validated[2]

The loan policy, at a minimum, should outline these same factors.

Monitoring Framework

To promote appropriate risk identification, measurement, and monitoring, the loan policy should clearly identify and establish procedures related to the ongoing management of the loan portfolio and identify the appropriate staffing level and skill sets required for such tasks.

Monitoring and reporting on the performance and collateral of loans should start immediately following the dispersal of loan proceeds. Therefore, the individual, group(s), or committee(s) responsible for ongoing monitoring, controls, and incentives should be well established to ensure appropriate oversight. While a bank may choose different management approaches for credit monitoring, many banks have the business line serve as the first line of defense for ongoing monitoring in order to leverage their lending expertise to identify potential issues and to maintain a strong, ongoing relationship with the borrower. This approach, however, is not a requirement.

The monitoring framework should also include an assessment of compliance with the bank's underwriting criteria. This includes testing loan covenants, both positive and negative, to evaluate whether the borrower is complying with loan covenants or is in technical default, or whether the repayment of principal is expected or jeopardized.

Management Information Systems and Reporting

Sound MIS and reporting will enhance the efficiency and effectiveness of lending decisions, ongoing portfolio monitoring, and overall credit management. The loan policy should clearly identify the primary monitoring reports necessary to support credit management and to establish the frequency for producing the reports. Reports should be targeted to the user and based on the level of oversight and granularity required for management, committees, and the board. For example, management reports may be more granular, while board reports may provide a high-level yet comprehensive overview of lending activity and risks.

All reporting should be relevant and adequately convey the level of detail required by the end user. Reports should be expressed in both dollar and percentage changes along with volume and/or transaction details. This level of detail will provide a balanced report so that a single large-dollar transaction does not unnecessarily skew reports that have a significant volume of low-dollar transactions.

The following information should be readily available and routinely reviewed by management:[3]

- Total loans and commitments
- Pipeline reports (to identify emerging concentrations or risks)
- Loans in excess of existing credit limits
- New extensions of credit, credit renewals, and restructured credits
- Delinquent and/or nonaccrual loans
- Credits adversely graded or requiring special attention
- Credits to insiders and their related interests
- Credits not in compliance with internal lending policies, laws, or regulations

For the board of directors to be fully effective, bank management should provide the board with sufficient information that will enable directors to understand the key risks in the loan portfolio and assess the adequacy of risk management practices and internal controls. The board of directors should receive board meeting materials far enough in advance of a meeting to promote active meeting participation.[4]

Internal Controls

Internal controls, such as internal audit, loan review, and credit administration, are critical functions that play an important role in maintaining effective monitoring of the lending process. The loan policy should establish a system for loan review to confirm that credit policies, underwriting procedures, and internal rating assignments are being thoroughly reviewed by experienced and independent personnel. A system for ongoing loan reviews should provide management with sufficient information to assess adherence to internal policies and the ability of approvers to accurately risk rate credit exposures.[5]

Audit Function. To be able to assess whether the lending function's design and controls are effective and working appropriately, the board of directors or its audit committee should require regular comprehensive audits of the function. The audit plan should be risk-focused and incorporate coverage of key lending areas, including areas in which concentrations exist. Audits also should include adequate testing of compliance of the lending function with the bank's policies and procedures. Additionally, the audit function should review compliance with loan documentation standards and federal and state banking laws and regulations, as well as the accuracy of past-due and charge-off reports. Audits should be conducted with appropriate frequency, and adequate resources should be assigned to perform the review. The scope of the audit should be suitable for the desired coverage. The audit function either can be housed internally or outsourced, based on the size and complexity of the bank's lending activity and operations. The board of directors is ultimately responsible for determining whether the audit function is performed in house.

Loan Review Function. The responsibility for underwriting and structuring a loan according to policy and for confirming that a loan is performing to expectations rests primarily with the line of business or the party approving the credit. The line of business is also responsible for appropriately risk rating the credit and promptly identifying any emerging issues or deterioration in the credit. An independent loan review function may be used to provide additional oversight of the portfolio. Similar to the audit function, this function can be housed internally or outsourced to a qualified and independent candidate or firm; however, as with all delegated functions, ultimate responsibility for sound risk management remains with the bank.[6]

Loan review plays a critical function by providing an independent assessment to senior management and the board about the bank's overall level of credit risk, effectiveness of credit risk management, and identification of potential risks that could negatively impact the portfolio. An overview of the loan review function and its responsibilities is outlined in Attachment 1 of SR letter 06-17, "Interagency Policy Statement on the Allowance for Loan and Lease Losses (ALLL)."[7] The attachment discusses the elements for establishing an effective loan review system.

The duties and responsibilities of the loan review function should be formally documented within the larger policy framework. The loan review policy should establish the required level of portfolio coverage and time frame(s) within which the reviews should be conducted. Loan reviews should be risk-focused, and the portfolios and individual loans that pose the greatest risk to the organization should be reviewed on a more frequent basis. The loan review scope should be clearly defined yet flexible enough to identify any new emerging risks.

Credit Administration — Loan Policy Compliance. Ongoing compliance reviews, along with a clearly articulated loan policy, impose discipline and sound loan administration. Pressures related to productivity and competition may result in lenders being inappropriately motivated to relax credit underwriting standards or to approve a loan that is not fully compliant with all aspects of the loan policy. While exceptions to a policy may be appropriate, a bank should have an MIS that properly identifies, justifies, and approves all exceptions.

A bank's loan policy should establish clear processes for requesting, approving, and documenting policy exceptions. The policy should also require aggregate reporting of all exceptions to the board or a board committee and should include audit and/or loan review mechanisms to identify unreported exceptions.

Problem Loan Workout

The main objective in problem loan workout is to enhance or preserve the bank's overall position with respect to cash flow and collateral; therefore, early detection of problems is the key to success. The loan policy should appropriately address the main aspects of problem loan workout, including practices and procedures surrounding nonaccrual status, troubled debt restructuring, and foreclosure. The policy should also cover the general administration and reporting processes within the loan workout function.

The workout of problem credits can be done within the line of business or, if appropriate, may need to be removed from the line of business to a separate unit that focuses solely on problem loan resolution. There are multiple benefits to retaining the workout

*(**Loan Policy, Pt 3** continued on next page)*

(*Loan Policy, Pt 3 continued from previous page*)

function within the line of business, including familiarity with the borrower and the global borrowing relationship; however, moving a troubled borrower out of the business line's oversight may allow lenders to focus on new business development and to work with performing borrowers. A dedicated workout staff can also focus on developing, implementing, and monitoring the workout strategy.

The decision to implement a standalone workout function may depend on criteria such as staffing availability and expertise, the number and dollar amount of problem credits, and the overall likelihood of reducing losses through the implementation of a separate workout function.

Conclusion

One of the most significant risks facing community banking organizations today is credit risk, and maintaining a current and comprehensive loan policy is one of the most effective ways to mitigate that risk.

For most community banks, the credit risk profile is directly correlated to the quality of the loan policy. The policy and procedures should be living documents that reflect current and emerging credit practices. Management and the board should continually monitor and evaluate the loan policy to determine that the bank's lending activities are conducted in a safe and sound manner and are aligned with its strategic objectives, current market practices, and economic conditions.

While the board is ultimately responsible for the development and annual approval of sound policies, many other parties within the bank are responsible for executing the board-approved strategy. An effective policy provides the road map for all bank staff to align their efforts with the bank's strategic direction.

Notes

* This is the third and final article in a three-part series. The first article, "Development and Maintenance of an Effective Loan Policy: Part 1," appeared in the Third/Fourth Quarter 2014 issue of *Community Banking Connections*, available at www.cbcfrs.org/articles/2014/q3-q4/development-and-maintenance-of-an-effective-loan-policy. This article covered several topics related to what should be contained in a community bank loan policy, including defining permissible activities and establishing responsibility for conducting a bank's lending activities in a safe and sound manner. The second article, "Development and Maintenance of an Effective Loan Policy: Part 2," was published in the First Quarter 2015 issue of *Community Banking Connections*, available at www.cbcfrs.org/articles/2015/q1/development-and-maintenance-of-an-effective-loan-policy. This article explored how lending activities can be administered and controlled through appropriate and sound underwriting criteria and practices. In addition, this article addressed documentation requirements and the ongoing maintenance of credit files.

1 For additional ALLL resources, see "Allowance for Loan and Lease Losses," *FedLinks*, January 2013, available at www.cbcfrs.org/assets/fedlinks/2013/january2013.pdf , and Stephen Wheatley, "Reversing the Trend: An Examiner's Thoughts About Negative Provisions and the ALLL," *Community Banking Connections*, First Quarter 2013, available at www.cbcfrs.org/articles/2013/Q1/Reversing-the-Trend. See also Board of Governors of the Federal Reserve System, *Commercial Bank Examination Manual* (CBEM), section 2070.1, "Allowance for Loan and Lease Losses," available at www.federalreserve.gov/boarddocs/supmanual/cbem/cbem.pdf , and SR letter 06-17, "Interagency Policy Statement on the Allowance for Loan and Lease Losses — Attachment 1, Loan Review Systems," available at www.federalreserve.gov/boarddocs/srletters/2006/SR0617a1.pdf.

2 Board of Governors of the Federal Reserve System, *CBEM*, section 2040.1, "Loan Portfolio Management, Credit-Grading Systems."

3 Board of Governors of the Federal Reserve System, *CBEM*, section 2040.1, "Loan Portfolio Management, Management Information Systems."

4 See Federal Reserve Bank of Kansas City, Division of Supervision and Risk Management, Basics for Bank Directors, "Know Where the Bank Stands," available at www.bankdirectorsdesktop.org.

5 Board of Governors of the Federal Reserve System, *CBEM*, section 2040.1, "Loan Portfolio Management, Internal Controls."

6 Board of Governors of the Federal Reserve System, *CBEM*, section 2040.1, "Loan Portfolio Management, Characteristics of Loan Review Program."

7 See SR letter 06-17, "Interagency Policy Statement on the Allowance for Loan and Lease Losses — Attachment 1, Loan Review Systems," available at www.federalreserve.gov/boarddocs/srletters/2006/SR0617a1.pdf.

CBI Education Foundation

Consider Making an Investment in Iowa's Future

The purpose of the Community Bankers of Iowa Education Foundation is to help improve the financial literacy of Iowa's students, to support higher education for Iowa college students and encourage senior level students to consider community banking as a career, to support community bankers' professional education, and to recognize the accomplishments of community bankers, both to the industry and their communities.

It is the Foundation's plan to build a self-sustaining source of support for financial education by soliciting both contributions for immediate project funding, and also larger donations to provide for additional funding through investment earnings. The Foundation is an IRS-approved 501(c)(3) organization, governed by the Community Bankers of Iowa Council of Presidents. Contributions made by both personal and corporate donors are tax deductible to the fullest extent of the law.

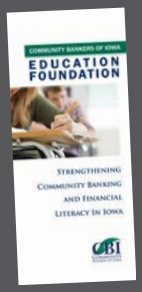
Major programs funded by the CBI Education Foundation include:

- Money Smart Week Elementary Poster Contest
- Community Bankers Intern Scholarship Program (New in 2015)
- Community Bankers of Iowa Leaders of Tomorrow Scholarship Program
- Community Bankers of Iowa Robert D. Dixon Founders Award Program
- Community Bankers of Iowa Leaders of Tomorrow Up and Coming Banker Award
- Ongoing educational opportunities for bankers and prospective bankers across Iowa.

Contributions of any size are accepted and encouraged. Various levels of recognition have been established to spotlight those who show enhanced support. Also in cooperation with the Community Foundation of Greater Des Moines, donors willing to make an endowment contribution can realize a 25% Iowa state tax credit in addition to deductibility. Contact us for details on this exciting program.

If you would like more information or to make a tax-deductible donation, find the Brochure and Donation Form on our website at cbiaonline.org/cbi-education-foundation.html, or contact Don Hole at 515.453.1495 or dhole@cbiaonline.org.

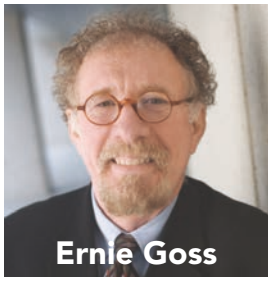
Contributions of any size are accepted and encouraged!



Would you like to make a tax-deductible donation to help ensure the future of community banking in Iowa? Visit our website at the address below to get more information, or to download the Brochure and Donation Form.

cbiaonline.org/cbi-education-foundation.html

Main Street Economic Survey



Rural Mainstreet Index Falls Below Growth Neutral for Fourth Straight Month: Record Low Agriculture Equipment Sales

December Survey Results at a Glance:

- For a fourth straight month, the Rural Mainstreet Index fell below growth neutral.
- Farm equipment sales declined to record low level.
- Bankers expect holiday Rural Mainstreet retail sales to expand by less than one percent from last year.
- Farmland prices declined again. Bank CEOs expect another 5.9 percent decline in farmland over the next year.

OMAHA, Neb. – The Creighton University Rural Mainstreet Index for December fell from November's weak reading, according to the monthly survey of bank CEOs in rural areas of a 10-state region dependent on agriculture and/or energy.

Overall: The Rural Mainstreet Index (RMI), which ranges between 0 and 100, sank to 41.5 from November's 43.7.

"This is the fourth straight month the overall index has declined, reflecting weakness stemming from lower agriculture and energy commodity prices and from downturns in manufacturing. Adding to the economic malaise was the free fall in beef prices over the past month," said Ernie Goss, Jack A. MacAllister Chair in Regional Economics at Creighton University's Heider College of Business.

According to Jim Eckert, president of Anchor State Bank in Anchor, Illinois, "Decreases in commodity prices and uncertainty for 2016 have resulted in lower land prices and reductions in machinery purchases. However, cash rents are staying about the same."

Farming and Ranching: The farmland and ranchland price index for December sank to 28.8 from November's weak 34.8. "This is the 25th straight month the index has moved below growth neutral. But, as in previous months, there is a great deal of variation across the region in the direction and magnitude of farmland prices with prices growing in some portions of the region," said Goss.

This month bankers were asked to predict the change in farmland prices in their area over the next year. On average bank CEOs expect farmland prices to drop by another 5.9 percent over the next year. As farm income has declined so has the share of farmland cash sales. Over the past year, the percentage of cash sales of farmland has declined by three percent. "I expect the percent of cash sales of farmland to decline even more in the months ahead," said Goss.

The December farm equipment-sales index plummeted to a record low 8.8 from 14.2 from November. "The strengthening U.S. dollar and global economic weakness have pushed farm commodity prices down by eight percent over the past 12 months. These weaker prices have discouraged farmers from buying additional agriculture equipment and have negatively affected the agriculture equipment dealers and manufacturers in the region," said Goss.

Jeffrey Gerhart, chairman of Bank of Newman Grove, Newman Grove, Nebraska, "Ag bankers and their farm customers should be stress testing their 2016 crop projections. Take their estimated projection of crop income and then lower it by 10, 20, 30 percent or more." Furthermore Gerhart said bankers and their customers need to "be prepared" for tighter margins going forward.

Banking: The December loan-volume index rose to 61.0 from last month's 59.6. The checking-deposit index declined to 64.7 from November's 70.7, while the index for certificates of deposit and other savings instruments climbed to 46.4 from 38.9 in November.

Hiring: Despite weaker crop prices and pullbacks from businesses with close ties to agriculture and energy, Rural Mainstreet businesses continue to add workers to their payrolls and at a faster pace. The hiring index jumped to 54.9 from 52.1 in November. "Rural Mainstreet businesses continue to hire additional workers as non-farm and non-energy related businesses continue to expand," said Goss.

Confidence: The confidence index, which reflects expectations for the economy six months out, increased to 39.8 from 38.9 in November, indicating a pessimistic outlook among bankers. "The recent free fall in beef futures prices combined with already anemic agriculture crop prices pushed bankers' economic outlook into this weak zone," said Goss.

Home and Retail Sales: The December home-sales index slipped to 55.0 from 56.5 in November. The December retail-sales index climbed to 51.2 from 43.7 last month. "Home sales on Rural Mainstreet have been very healthy over the last several months. On the other hand, Creighton's monthly survey has yet to measure any significant upturn in retail sales resulting from the downturn in fuel prices," said Goss.

Bank CEOs expect lackluster holiday sales growth from the 2014 season. On average, a one percent increase in retail sales for Rural Mainstreet businesses is expected.

The strong dollar, especially against the Canadian dollar, is depressing retail sales among border states. For example, John Marchell, president of the First State Bank Grand Forks, North Dakota, said, "The decrease in the number of Canadian retail

customers is noticeable."

Each month, community bank presidents and CEOs in nonurban agriculturally and energy-dependent portions of a 10-state area are surveyed regarding current economic conditions in their communities and their projected economic outlooks six months down the road. Bankers from Colorado, Illinois, Iowa, Kansas, Minnesota, Missouri, Nebraska, North Dakota, South Dakota and Wyoming are included. The survey is supported by a grant from Security State Bank in Ansley, Neb.

This survey represents an early snapshot of the economy of rural agriculturally and energy-dependent portions of the nation. The Rural Mainstreet Index (RMI) is a unique index covering 10 regional states, focusing on approximately 200 rural communities with an average population of 1,300. It gives the most current real-time analysis of the rural economy. Goss and Bill McQuillan, former chairman of the Independent Community Banks of America, created the monthly economic survey in 2005.

Colorado: The state's Rural Mainstreet Index (RMI) increased to 46.3 from 43.4 in November. The farmland and ranchland price index improved slightly to a frail 20.9 from November's 19.7. Colorado's hiring index for December rose to 51.1 from November's 47.2.

Illinois: The December RMI for Illinois declined to 39.8 from 43.2 in November. The farmland-price index fell to 24.8 from November's 28.6. The state's new-hiring index expanded to 52.6 from last month's 50.8.

Iowa: The December RMI for Iowa sank to 40.8 from November's 44.3. Iowa's farmland-price index for December increased to 32.1 from November's 28.6. Iowa's new-hiring index for December advanced to 55.2 from 50.9 in November.

Kansas: The Kansas RMI for December sank to 39.2 from November's 43.9. The state's farmland-price index for December fell to 24.7 from November's 28.8. The new-hiring index for Kansas climbed to 52.2 from 50.9 in November.

Minnesota: The December RMI for Minnesota slumped to 37.0

(***Rural Mainstreet*** *continued on next page)*

Tables 1 & 2 summarize survey findings

Next month's survey results will be released on the third Thursday of the month, Jan. 21.

Table 1: Rural Mainstreet Economy One Year Ago and Last Two Months: (index > 50 indicates expansion)

	Dec. 2014	Nov. 2015	Dec. 2015
Area economic index	50.0	43.7	41.5
Loan volume	76.7	59.6	61.0
Checking deposits	62.1	70.7	64.7
Certificates of deposit and savings instruments	44.0	51.1	46.4
Farmland prices	38.6	34.8	28.8
Farm equipment sales	23.7	14.2	8.8
Home sales	51.7	56.5	55.0
Hiring	55.2	52.1	54.9
Retail business	55.3	43.7	51.2
Confidence index (area economy six months out)	42.5	38.9	39.8

Table 2: The Rural Mainstreet Economy, December 2015

	Percentage of bankers reporting				
	Less than 5%	5% to 9%	10% to 19%	20% to 32%	Greater than 32%
What percent of farmland purchases in your area do you estimate are cash sales (not financed)?	12.1%	12.4%	39.0%	17.1%	19.4%
	Decrease more than 12%	Decrease 6% to 12%	Decrease 1% to 5%	No Change	More than 1%
Over the next year, what change in farmland prices do you expect in your area?	15%	35%	32.5%	12.5%	5.0%
	Down 4% to 10%	Down 1% to 3%	No change	Up 1% to 4%	Up more than 5%
For retailers in your area, what is your expected increase/decrease in sales from the 2015 holiday buying season? Holiday sales compared to last year will be:	7.5%	20.0%	22.5%	37.5%	12.5%

Follow Ernie Goss on Twitter: www.twitter.com/erniegoss

For historical data and forecasts, visit: www2.creighton.edu/business/economicoutlook

(***Rural Mainstreet*** *continued from previous page)*

from November's 43.3. Minnesota's farmland-price index slumped to 17.8 from 28.5 in November. The new-hiring index for the state slipped to 50.0 from last month's 50.8. "Record yields in our area. Cash flows better than projected with the warmest winter we have ever had," said Pete Haddeland, CEO of the First national Bank in Mahnomen.

Missouri: The December RMI for Missouri dipped to 38.6 from 39.4 in November. The farmland-price index plummeted to 22.6 from November's 30.9. Missouri's new-hiring index expanded slightly to 51.8 from November's 51.7.

Nebraska: The Nebraska RMI for December slumped to 36.3 from 40.1 in November. The state's farmland-price index fell to 12.3 from November's 20.8. Nebraska's new-hiring index increased to 48.0 from 47.7 in November.

North Dakota: The North Dakota RMI for December decreased to a regional low of 29.8 from November's 31.3, also a regional low. The farmland-price index sank to 20.0 from 37.0 in November. North Dakota's new-hiring index declined to 30.0 from November's 31.0.

South Dakota: The December RMI for South Dakota fell to 44.3 from 46.9 in November. The farmland-price index sank to 45.3 from 49.2 in November. South Dakota's new-hiring index expanded to a healthy 60.0 from November's 59.0.

Wyoming: The December RMI for Wyoming increased to 43.6 from November's 42.3. The December farmland and ranchland-price index climbed to 32.0 from 30.2 in November. Wyoming's new-hiring index rose to 55.2 from November's 51.4.

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News from CBI Services & Insurance Members

NEW HIRE: Bankers' Bank Welcomes New President/CEO

Brad Stamper, Bankers' Bank's new CEO.

During 2015, Bankers' Bank conducted extensive research and interviews to find a new President/CEO. We are pleased to announce that Bradlee F. Stamper will become the President/CEO of Bankers' Bank and Bankers' Bancorporation as of December 7, 2015.

Brad is a graduate of Marietta College, Marietta, Ohio. He brings with him over 33 years of experience in banking, both at community and regional bank levels and in such areas as commercial, retail, consumer and mortgage lending, finance, marketing, risk management, sales and strategic planning.

On December 7, Edie Tholo, who served as President and CEO in the interim, will resume the role of Executive Vice President.

Bankers' Bancorporation, Inc. is the parent company of Bankers' Bank, a bank-owned correspondent based in Madison, Wis., since 1981. Bankers' Bank serves community-minded financial institutions of all sizes across the Midwest through support offices in the Springfield, Ill., Des Moines, and Indianapolis areas. We do not serve the general public; therefore, we never compete with our clients for business. More information on CBI Associate Member Bankers' Bank is available at BankersBankUSA.com.

NEW HIRE: Voss Hired at Bell State Bank & Trust

Mary Voss, Bell State Bank & Trust's new VP/ Correspondent Banking Business Development Officer.

Mary Voss has accepted a position as vice president/correspondent banking business development officer at Bell Sate Bank & Trust with headquarters in Fargo, N.D. She will reside and work in Iowa where she will be building relationships with community banks. Her banking network will also extend into the Nebraska and Illinois markets. She brings 23 years' banking experience to Bell State Bank & Trust.

Mary is a graduate of Bellevue University in Bellevue, Neb. and Graduate School of Banking in Madison, Wis. She has served on numerous Economic Development Committees, Chamber of Commerce Boards, Community Banking Committees and is currently a member of the Pleasant Hill Cares Committee. She has two children and resides in Pleasant Hill, Iowa with her husband Terry.

Founded in 1966, Bell Sate Bank & Trust is the largest independently owned bank in North Dakota, South Dakota and Minnesota with 20 banking locations and more than $3.5 billion in assets. For more information on CBI Associate Member Bell State Bank & Trust, visit www.bellbanks.com.

See full lists of CBSI providers at cbiaonline.org/services--insurance.html

Join the growing list of Endorsed Partners of Community Bankers of Iowa!

For more details on the endorsement process, please contact Jackie Haley, Membership Services Director at 515.453.1495 or jhaley@cbiaonline.org.

CBI Member Benefits: Did You Know About Community Bankers Services & Insurance (CBSI)?

Save money AND support your association! Providing best of breed services, products and insurance to member banks has been the mission of Community Bankers Services and Insurance (CBSI) since 1984. CBSI provides exclusive CBI-member pricing on a range of products and services and the benefits of joint purchasing power, while at the same time benefiting the association.

CBSI has done the research for you! Endorsed service providers undergo a rigorous due diligence process and are ultimately chosen by a panel of community bankers. Critical due diligence is always performed when launching new services. The review process for each program is intended to ensure that no service program is undertaken unless it will prove to be beneficial for the membership.

CBSI and its partners continue to work together to enhance member products and services. The CBSI Board of Directors meets quarterly to review endorsed vendors and consider new partnerships, often suggested by members. Your bank and your association will benefit when you have a choice of the best providers.

So...is YOUR bank reaping the benefits of Community Bankers of Iowa Services and Insurance products and services?

Scholarship Encourages Students to Understand Student Loan Debt

As rising college costs and the accompanying student loan debt continues to be a concern for Iowa families, more efforts are underway to educate college-bound high school students on how to reduce their debt. Many young adults, however, find it difficult to believe that they will be unable to repay student loan debt once they leave college.

This situation affects the students and families in your community and across Iowa. One student loan company provides two unique and interactive online tools for free — and offers college scholarships to students who use them — as part of the Iowa Financial Know-How Challenge: Senior Scholarship. The scholarship is open to any Iowa high school senior who plans to attend college in fall 2016.

Iowa Student Loan is providing 30 college scholarships of $2,000 each to Iowa high school seniors who complete Student Loan Game Plan and ROCI Reality Check as part of the Iowa Financial Know-How Challenge: Senior Scholarship. As a community banker, you may request free materials to promote this scholarship and the financial literacy tools it encompasses to your customers.

About the Scholarship
The Iowa Financial Know-How Challenge: Senior Scholarship is designed to bring awareness of potential student loan debt and the problems of over-borrowing for college to high school students. To qualify, interested high school seniors register online at www.IowaStudentLoan.org/SeniorScholarship and then receive instructions for completing three online elements:

1. Student Loan Game Plan provides information on the recommended maximum borrowing level based on expected starting salaries for specific college majors. Features include videos telling real borrowers' stories about problems resulting from too much college debt, interactive scenarios for reducing borrowing and increasing earnings, and a sample post-college monthly budget that includes estimated student loan payments. The tool was recently completely redesigned.
2. ROCI Reality Check explores jobs held and salaries earned by actual graduates of specific college majors and information on how to prepare for a career to maximize earnings to get the highest return on college investment, or ROCI.
3. A multiple choice assessment related to Student Loan Game Plan and ROCI Reality Check.

The students with the top 30 scores on the assessment will each be awarded a $2,000 scholarship for college expenses in fall 2016. If a tiebreaker is necessary, tied students will be asked to write and be judged on a short essay.

Each recipient's high school will also receive a corresponding award of $500.

In addition, to the important college and student loan information conveyed in the two online tools, each registered student receives a series of emailed tips on college planning and financial literacy.

Students must register and complete all three online steps by 4 p.m. (Central time) March 4, 2016.

Free Promotional Materials Available
To help you promote this scholarship and the financial literacy tools that come with it promotional information is available for free at www.IowaStudentLoan.org/Promote. Online materials include sample posts suitable for websites and social media, a newsletter or blog article and printable posters.

Iowa Student Loan will also provide website banner ads, printed posters and fliers upon request and at no charge. (Quantities for free printed materials may be limited.)

For more information about the Iowa Financial Know-How Challenge: Senior Scholarship or to request materials, please email lenderservices@studentloan.org or call (800) 508-1660 toll free. For more information on CBI Affiliate Member Iowa Student Loan visit www.iowastudentloan.org.

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Call Protection, at Rock-Bottom Prices

Spreads for Callables Reach Cyclical Lows

Written By: Jim Reber
President & CEO
ICBA Securities/Vining Sparks

It can be difficult to discern what securities are of value these days. Even though we seem on the precipice of rate hikes, short-term yields (in particular) remain mired in cyclical lows. The two-year Treasury yield, for example, hasn't been over 1 percent in over five years. The five-year note hasn't seen 2 percent for over four years. Where can an investor go for value?

Eye of the Beholder
In times like these, it's necessary to talk about relative value. Maybe before our careers are over we'll be able to buy bonds at 7 percent yields, with maturities and credit qualities that are acceptable, but a lot of unusual circumstances will have to occur in concert before that happens.

One variable that is certain to change if rates rise is the cost of carry for community banks. At last look, the 300+ institutions that use Vining Sparks Risk Manager for its interest-rate risk management report an all-in cost of funds of 39 basis points. What this means is that some relatively paltry yields on assets can actually create some respectable net margins.

Another way to quantify value is to study the spread history on certain popular community bank investments. One sector that is large and liquid is federal agency bonds. These are debt instruments issued by your favorite Government-Sponsored Enterprise (GSE), e.g., Fannie Mae, Freddie Mac and the Federal Home Loan Bank. They comprise about 15 percent of a typical investment portfolio, and they are widely seen as fungible, which makes spread analysis very straightforward.

Why So Narrow?
Today, a community bank can purchase a five-year agency bond that is non-callable at a spread of about 12 basis points (0.12 percent) over a comparable Treasury. If you, as an informed investor, are willing to buy a callable bond, which can be refunded to you as early as 90 days from now if the agency/issuer so chooses, you can eek out another 10 basis points on top of that.

That additional 0.10 percent to take on call risk for most of the life of the bond is miniscule. Just a year ago, the incremental yield was more than twice that. There have been times in the last five years in which incremental spreads were over 40 basis points. We can therefore state that callables have outperformed bullets lately.

The question is, why? The answer is logical, and twofold. Supply/demand has helped to make spreads collapse. There are fewer true callable agencies, as the GSEs have collectively been shrinking their balance sheets pursuant to congressional mandate. At the same time, investors have been more willing to take on call risk at the advent of a rate-hike cycle, theorizing that if nothing gets called, they at least have more yield than a bullet, regardless of how puny.

Spreads as Rates Rise
I hasten to remind community bank investment managers what typically happens to yields as rates rise: Spreads tighten. Yes, tighten. The reason is related to the fundamentals of lending. If general interest rates are rising, it is in response to an expanding, and probably inflationary, economy.

As the economy improves, the chances of borrowers meeting their obligations to lenders also improve. As the credit quality, in fact or presumed, increases, a lender will accept a smaller relative return. This plays out in the yields and spreads in your community bank's own investments and loan portfolio every day.

However, as I write from a trough in the rate cycle, and also a nadir in the history of spreads, something is going to give. I would suggest that spreads will remain very tight, given the restriction on supplies for the near future. What this means from a relative value proposition is that bullet agencies are inexpensive, and should be carefully considered when buying this sector. If, and when, widening occurs, bullets can be very good swap candidates for layering in additional callable debt.

Jim Reber (jreber@icbasecurities.com) is President and CEO of ICBA Securities, ICBA's institutional fixed-income broker/dealer for community banks. For more information on CBI Endorsed Member ICBA Securities/Vining Sparks, visit icbasecurities.com.

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- client feedback

Community Bank Balance Sheet Case Study

▲ 30%

NIM Improvement

additional case studies on the reverse

Balance Sheet Goals

- Protect current income
- Increase future income
- Reduce overall Interest Rate Risk

Balance Sheet Strategies

- Hedged deposit costs & added long duration fixed rate wholesale funding to protect against rising rates & runoff
- Replaced low relative value securities with floating munis & SBAs
- Sold long duration loans & bank started offering fixed/floating loans to borrowers

Balance Sheet Impact

- Reduced +300 EVE risk by 40%
- Improved +300 EAR by 80% & NIM 30%
- Income neutral (accretive +300)
- 12 month breakeven on onetime loss