Nebraska Banker

MARCH/APRIL 2021

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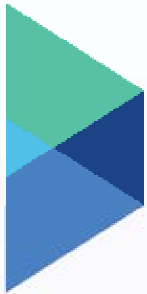

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Nebraska Banker

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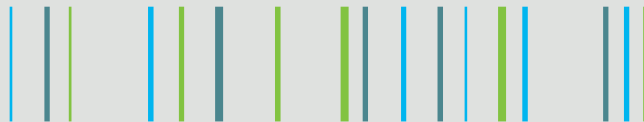

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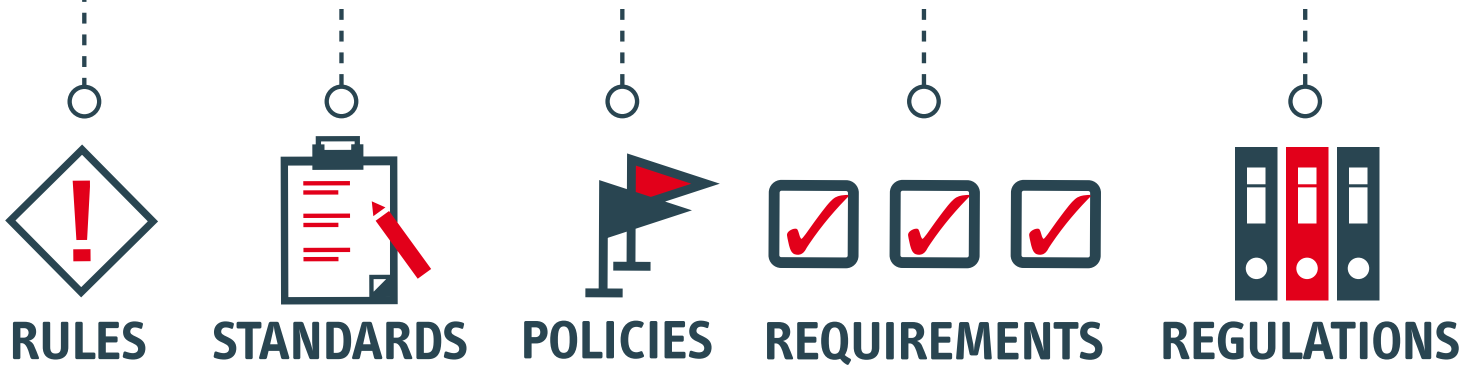

Richard J. Baier, President and CEO, Nebraska Bankers Association

NBA Friends:

A common frustration shared by our members regardless of their size, geography, or business model is complying with the ever-growing rules and regulations imposed by various regulatory agencies. As a result of input received from members, your NBA board of directors recently approved expanding our existing partnership with Compliance Alliance (C/A) to offer access to compliance audit services through Review Alliance and a new Virtual Compliance Officer (VCO) program. These services will be offered to NBA members at highly competitive rates. These services are part of Bankers Alliance (B/A), the only national compliance company created for bankers by bankers and now includes C/A, Review Alliance (R/A) and the VCO.

In 2012, the NBA partnered with 23 other state bankers' associations to create C/A. C/A provides a subscription-based, comprehensive compliance service. Subscribers have access to compliance officers via phone, email or chat. Compliance calendars, unlimited document reviews, bank training programs, forms, flowcharts, checklists, compliance tools, and more are also part of the bank subscription license. Twenty-seven NBA members currently subscribe to C/A. It is important to note banks that subscribe to C/A also receive free access to the NBA's Compliance Handbook. I have talked with a number of our C/A customers who tell me it is one of their most valuable vendors.

R/A was founded in 2020 to offer competitively priced compliance audit services to bankers within the BA footprint. Audits are conducted by highly trained and certified staff and provide a risk-based approach to compliance testing. Transactions are reviewed efficiently and effectively, focusing on streamlining the review process by using technology whenever feasible. All audit services include exit meetings with bank personnel. Bank management responses are incorporated into every final product. R/A audits regularly pass regulatory scrutiny by federal regulators.

Bankers often joke that the fastest-growing job within the industry is the position of "compliance officer." The VCO program was designed as an alternative for banks who struggle to find and retain competent and committed compliance staff. A highly trained compliance specialist serves as the VCO for several financial institutions across the country in its simplest format. While your bank still maintains an internal staff member with the title of "compliance officer," the VCO serves as a banks' compliance expert. Benefits of using a VCO include retaining highly trained staff that are continuously educated on the ever-evolving world of compliance, monthly monitoring, and communication to access daily risk, compliance committee steering, policy and procedure guidance, reduction of staff

turnover, a single point of contact, and lower overall cost. Banks who have engaged a VCO report successful interactions and results with their regulators.

The NBA has offered products and services to support members with their compliance challenges for more than three decades. Our Legal and Compliance team routinely offers periodic Compliance Updates, which summarize recently issued federal and state regulatory guidance. These Compliance Updates can be easily accessed on the NBA website. Similarly, 80 members take advantage of the subscription-based NBA Compliance Handbook.

The burden associated with ensuring a solid compliance program will undoubtedly increase as banks are subject to political, societal and business evolution. As you search for the best strategies to meet your regulatory and compliance responsibilities, I encourage you to consider the offerings available through the NBA. If you want to learn more, please contact me at richard.baier@nebankers.org or Jennifer Heaton at jennifer.heaton@nebankers.org. Additional information can be found at https://www.nebankers.org/compliance-alliance.html

Until next time, let's keep working together to meet our customers' financial needs and grow our communities!

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A Robust Recovery Requires Consistent "Rules of the Road"

Rob Nichols, President and CEO, American Bankers Association

THROUGHOUT THE PANDEMIC, THE U.S. ECONOMY HAS BEEN tested like never before and has more than proven its resilience. That's thanks in no small part to our large and diverse financial system: a network of financial institutions of all sizes, charters and business models dedicated to providing the products and services that consumers and businesses need to thrive.

The diversity of our financial system is something that is uniquely American. We must preserve that diversity — but we must do so in a manner that protects all consumers equally and ensures a level playing field between providers of financial services.

In ABA's recently released Blueprint for Growth, a banker-driven document that will serve as our advocacy north star in the year ahead, we identified the need to promote innovation and ensure consistent regulation as one of the industry's top priorities in 2021.

This plan is not new, but it remains important as we confront modern life challenges — from emerging technologies to a changing climate to recovering from a global pandemic.

Banks have always embraced innovation. Indeed, innovation has a vital role in increasing economic competitiveness, promoting financial inclusion and expanding access to banking services. But financial innovation only provides these benefits when undertaken in a safe, responsible manner.

A consistent set of regulatory standards must be applied to financial services providers, including credit unions, banks or fintech firms. Unfortunately, we've seen several instances in recent months of firms attempting to circumvent these regulatory standards by seeking charters that would allow them to access the banking system without being subject to the same rigorous regulatory standards applicable to the nation's banks.

A prime example of this is Figure Bank, which recently applied for a national banking charter through the OCC that, among other things, would allow it to operate without deposit insurance. If approved, this charter would enable Figure Bank to apply for membership in the Federal Reserve system while avoiding compliance with regulations like the Community Reinvestment Act.

We'll continue to oppose the approval of charters like these, and we'll continue to push back against any efforts that would enable new entrants into the financial services marketplace to cherry-pick which rules of the road apply to them.

We'll also continue our efforts to advocate against further tilting the field for tax-advantaged entities like credit unions and the Farm Credit System. For example, we are pushing

strongly against a recent National Credit Union Administration effort to further loosen the field of membership restrictions. Even the agency's former chair blasted the move as "abandon[ing] rigorous and introspective analysis and its congressional mandate to stay clearly within the four corners of the Federal Credit Union Act."

> A prime example of this is Figure Bank, which recently applied for a national banking charter through the OCC that, among other things, would allow it to operate without deposit insurance.

Should policymakers accelerate attempts to push the Federal Reserve or the U.S. Postal Service into retail banking, we'll continue making the case that this kind of involvement is unnecessary because consumers are already well-served by a broad and diverse financial services sector. According to the FDIC, the share of unbanked U.S. households in 2019 reached a record low of 5.4%. Banks are working to close that gap further through the Bank On movement, and a fast-growing number of banks have signed on. Bank On certified accounts are now offered in 28,000 branches nationwide, in 99 out of the 100 largest metropolitan markets and in all 50 states.

For us to convey this message, however, we must ensure that community banks have the capacity and ability to keep innovating. That's why we've been working diligently through ABA's Core Platforms Committee to smooth over some of the bumps in the road that have historically held banks back from rolling out new digital products and services that their customers want and that they need to remain competitive.

By supporting the digital transition — an effort that was well underway before the pandemic but is now accelerating at an even faster pace — America's banks can continue their work to support an economic recovery that is robust and inclusive. ◗

Email Rob Nichols at rnichols@aba.com.

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Collecting Your Loan from an Insolvent Probate Estate

Randy Wright and **Jesse Sitz**, Partners, Baird Holm, LLP

WHEN A PERSON DIES WHILE INDEBTED AND ESTATE assets appear insufficient to pay all the debts, lenders may want to look carefully at the probate process. There are options and tools available to help collect at least a portion of the debt, even if the estate appears to be insolvent. This article will highlight some basic concepts involved in collecting from an insolvent probate estate.

A. Verifying that a probate estate exists — or causing one to be opened.

Just because someone dies does not mean that a probate case will necessarily be opened. For example, if a decedent's property passes through "non-probate" transfers — e.g., joint tenancy, transfer on death or payable on death designations, or transfers to a trust — the property would pass by operation of law to family members or other recipients. Also, family members may be unfamiliar with the probate process or fear its costs and may not understand that it might be needed.

But if creditors are not being paid, they can urge heirs to file a probate. Failing that, a creditor has the option of starting probate proceedings themselves, even without the cooperation of heirs.

Creditors who think that a probate case might already exist but who have not received a notice should inquire at the county where the decedent lived. The court clerk should be able to check on pending probates, and lawyers can also access that information.

Creditors of a decedent are considered "interested parties" by Nebraska law and can therefore file a petition to probate an estate, even if no heir has done so. That creditor can even nominate its own representative to be the personal representative of the estate. A family member or close family associate can also be asked to serve.

B. Filing a claim in the probate proceeding.

Once a probate proceeding is opened, the creditor should file a claim against the estate. Generally, a claim should be filed within 60 days of the date of mailing of the notice by the personal representative providing the creditor with notice of the probate's opening. If a creditor fails to file a claim, the creditor may be able to proceed against collateral if properly secured but may not be able to proceed against the estate for personal obligations of the decedent, such as personal guaranties.

Creditors who think that a probate case might already exist but who have not received a notice should inquire at the county where the decedent lived. The court clerk should be able to check on pending probates, and lawyers can also access that information.

C. The estate inventory.

After filing a claim, a lender should review the estate inventory. The inventory is due to be filed within three months after a personal representative is appointed. If properly prepared, it will catalog the decedent's assets at death, including jointly held property that passed upon death and the fair market values. If not timely filed, the creditor can bring this to the attention of the probate court.

But that inventory probably won't tell the whole story. Until all creditor claims are filed, the total debt amount won't be known. Once the claims bar date passes, the lender can review creditor claims and determine if the estate is likely solvent or insolvent. An additional way to check for non-probate property is to review a decedent's Nebraska inheritance tax return. A properly completed inheritance tax return will list all assets in which the decedent had an interest, including assets passing through non-probate transfer. The inheritance tax return is required to be filed with the county court within 12 months of the decedent's death.

D. Enlarging the Estate Assets

Once it becomes clear that the estate is likely insolvent, the creditor may want to look at several ways to enlarge the estate to pay debts.

1. Bringing joint tenancy property, "payable on death," and other non-probate assets back to the estate.

Nebraska law provides that if other estate assets are insufficient, transfers resulting from a right of survivorship (joint tenancy property), a "payable on death" ("POD") designation on a bank account or a "transfer on death" ("TOD") for securities, are not effective against the estate to the extent it is needed to pay claims and statutory allowances. Neb. Rev. Stat. § 30-2726(a). One who receives payment from an account after the death of the decedent "is liable to account to the personal representative for a proportionate share of the amount received to the extent necessary to discharge estate claims." In other words, the joint payee must pay the funds received from a joint account or other non-probate property back to the estate, up to the amount needed to make the estate solvent.

However, the personal representative is not required to act unless it has received a "demand" from an interested party, such as a creditor or heir. The proceeding to recover the joint property or account funds has a time deadline — one year from the decedent's date of death. Creditors should be aware of this one-year cutoff. A demand made by a creditor after the one-year period has expired may be of no effect.

This is a very powerful tool for creditors. It is common for substantial property to change hands at the decedent's death due to joint tenancy, POD or TOD accounts. Often, those monies and property go to the surviving spouse or other family members. Those funds can be recovered for creditors under this statute, and in some instances, that may provide the difference between a solvent estate and an insolvent estate.

2. Recovery of pre-death fraudulent transfers

The personal representative can also bring a claim for transfers the decedent made during his lifetime that were fraudulent as to creditors. These could include, for example, transfers of money or property to family members where there was no adequate consideration received, if the transfer was made while the decedent was insolvent, or if the transfer rendered him or her insolvent.

E. What if the Personal Representative is Not Acting Responsibly?

Sometimes, the PR may not be fully cooperative in collecting assets to pay creditors. This might be for any of several reasons. For example, the PR may have benefited from the receipt of joint or other non-probate property received upon the decedent's death and may be unwilling (or feel unable) to repay it. Or, those funds may have gone to other family members, leaving the PR reluctant to make demands upon them. Or, overwhelmed by the death of a loved one and the responsibilities of the estate, the PR may not be emotionally able to address the necessary liquidation of property for payment of estate debts. Fortunately, the probate code provides ways to address these issues.

COUNSELOR'S CORNER — continued on page 14

COUNSELOR'S CORNER — continued from page 13

1. Appointment of a "Special Administrator"

Nebraska courts can appoint a special administrator in many circumstances, including where the personal representative has a conflict of interest, such as when the PR or a family member benefited from non-probate property that is now needed to pay creditors. The creditor can ask the court to appoint someone to take up the job of collecting non-probate or fraudulently transferred property or where the court otherwise finds it necessary to preserve the estate. (Neb. Rev. Stat. §30-2507(2)). The special administrator — sometimes but not always a lawyer — can be compensated from estate assets. A special administrator can also pursue claims against the personal representative if that person has breached their fiduciary duty to the estate. Neb. Rev. Stat. 30-2474 may make the PR personally liable for those acts.

2. Replacement of the PR.

In situations where the PR is not acting responsibly, the Nebraska statutes permit an interested party to ask the court to replace the PR with someone else upon a showing of sufficient cause. Neb. Rev. Stat. §30-2454 allows interested parties — which would include creditors — to petition the court to remove a PR. Grounds for removal include, broadly, the "best interests of the estate" or if the PR misrepresented material facts in the proceedings or has mismanaged the estate. The court can appoint a successor PR, which could be a family member or an unrelated third party.

F. Priority for Payment of Claims

Creditors should be aware of the priority for payment of claims from the estate. Creditors with unsecured claims do not have first priority as to funds in the estate. Generally, the priority order for payment of claims is as follows:

(1) Estate administration costs;
(2) Reasonable funeral expenses;
(3) Debts and taxes with preference under federal law;
(4) Reasonable and necessary medical and hospital expenses of the last illness;
(5) Debts and taxes with preference under Nebraska law; and
(6) All other claims.

Most unsecured claims will fall under (6). However, creditors who have secured collateral can proceed against the property outside of the probate proceedings, for example, by way of foreclosure proceedings.

CONCLUSION

When lenders believe that their claims against a decedent are in doubt due to the estate's potential insolvency, they should step up their activity to learn more about the estate left by the decedent. It may be advisable to retain counsel to fight to gather and liquidate assets to bolster the estate for creditors.

Randy Wright and Jesse Sitz, Partners, Baird Holm, LLP

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Customer Cybersecurity Awareness – Creating a Culture of Security

Eric Chase, Information Security Consultant - SBS CyberSecurity, LLC

WHILE MOST ORGANIZATIONS THINK THROUGH THE DIRECT risk of cyber threats to their business via cyber attacks, known vulnerabilities, and security flaws, not many organizations recognize the risk posed by their customers.

There are (typically) two different types of customers:

- **Commercial Customers (B2B)** – other businesses doing business with your organization.
- **Consumers (B2C)** – individuals who utilize your online-based products and services.

Customers Have Less Security

More often than not, businesses (particularly those in regulated industries) have stronger cybersecurity controls in place than customers. Think about your customers – commercial or consumer – and ask yourself who has stronger cybersecurity controls? If you're not the winner of that debate, it may be time for some cybersecurity assistance.

In many cases, the poor cybersecurity practices of your customers can lead to a compromise by a malicious attacker. A customer compromise can lead the malicious attacker to steal valuable information. In most cases, the customer compromise value proposition is email access, account access, or customer funds through financial institution(s).

In any case, the malicious attacker has the customer's information and can set the customer up for a cooperate account takeover (CATO) scenario. CATO comes in many forms, but the two most popular include draining customer bank accounts, redirecting funds to unauthorized payees, or business email compromise (BEC) attacks that steal money and further the attacker's agenda. Customer compromise is very difficult to combat and can often lead to reputational and monetary damage to your business.

Cover the Basics

An organization with a strong security culture goes beyond internal employees and talks about cybersecurity threats with its customers as well. Educating customers about the dangers of cyber threats helps build a stronger relationship with the customer. Stronger customers also benefit the business. A stronger customer will reduce the risk of their information becoming compromised or used maliciously against your business.

Your customers can benefit from the same security awareness topics shared internally, including:

- **Phishing and social engineering** – Educate customers on the different types of social engineering attacks and what controls can be added to mitigate the risk of an attack. Stressing the dangers of phishing emails and how the organization can defend against phishing is another key point to cover.
- **Physical security** – Educate customers about physical security threats and best practices.
- **Access controls, including passwords** – Educate customers on the importance of strong authentication mechanisms. Stress the importance of length vs. complexity when it comes to passwords and encourage the implementation of multi-factor authentication (MFA) whenever possible.
- **Remote access security** – Educate customers on the importance of securing remote workers through the use of VPNs, wireless network best practices, quality anti-malware programs, etc.
- **Use of encryption** – Educate customers on the importance of data encryption.
- **Mobile device security** – Educate customers about security controls for mobile devices, including strong passwords, biometric authentication, encryption, anti-malware programs, and Wi-Fi connectivity.
- **Malware awareness** – Educate customers about defending against malicious software.
- **Importance of anti-virus and firewalls** – Stress the importance of firewalls and the use of malicious program detection programs.
- **Security awareness** – Stress the importance of ongoing security awareness training and staying up-to-date about modern attacks.
- **Incident response plans** – Stress the importance of corporate customers building a plan to fail well (an incident response plan) in the event they are compromised.

How to Train Your Customers

Using multiple delivery channels to provide training and education can help ensure your customers see it throughout the year. Delivery channels can include:

- Your business website (your own content, your policies for handling information or disclosing cyber incidents, cybersecurity news or articles, or links to other cybersecurity training)
- Post cybersecurity resources or news on your social media channels
- Include cybersecurity resources with physical statements or invoices
- Provide cybersecurity resources, control suggestions, or self-audits at the time of account opening
- Conduct periodic audits of security controls at a customer's location

Actually Talk to Your Customers

One of the most popular and effective methods of training is to invite your customers to a virtual or in-person lunch-and-learn.

Getting out in front of your customers and talking about the importance of cybersecurity is a win/win/win:

1. You are helping to create stronger customers that are more resistant to cyber attacks, benefiting both you and your customer.
2. You show your customers they are more than just a number. You're strengthening relationships and demonstrating care about their well-being.
3. You have an opportunity to show off new products/services or new features, as well as potentially increase the adoption of existing products or services.

Talking about cybersecurity also offers a chance for your customers to see how your organization is protecting their information. In today's market, where cybersecurity is becoming a deciding factor for consumers presented with many options, being open and transparent about cybersecurity can instill customer confidence and draw in new customers.

Here are some additional considerations to keep in mind:

- Invite the community.
- Host several sessions to cover the most people possible. Consider recording the session for those unable to attend and/or to use for content later.
- Choose a platform (if virtual) that is easily accessible by your customers, user-friendly, and secure.
- Pair up with your chamber of commerce, a civic organization, or an academic institution.
- If you're not confident talking about cybersecurity yourself, bring in a cybersecurity expert to speak on your behalf.

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The National Defense Authorization Act: BSA/AML Initiatives

Elizabeth K. Madlem, Vice President of Compliance Operations, Compliance Alliance

ON JAN. 1, 2021, THE SENATE VOTED TO override President Trump's veto on the National Defense Authorization Act (NDAA or Act). It was previously overridden by the House back on Dec. 28, 2020. The NDAA included over 200 pages of significant reforms to the Bank Secrecy Act (BSA) and other anti-money laundering (AML) laws putting forth the most comprehensive set of BSA/AML reforms since the USA PATRIOT Act of 2001. The continuing question is, what are the implications of this Act? How will this impact not only financial institutions but also U.S. companies and companies doing business in the United States at large?

For starters, certain U.S. companies and companies doing business in the U.S. ("reporting companies") will be required to provide FinCEN with information regarding their beneficial owners. This includes names, addresses, dates of birth and unique identifying numbers. Newly incorporated companies will be required to do so at the time of incorporation. Exempt companies include public companies, as well as companies that: (i) have more than 20 full-time employees, (ii) report more than $5 million in yearly revenue to the Internal Revenue Service, and (iii) have an operating presence at a physical office within the United States. Changes in beneficial ownership will require reporting companies to provide FinCEN with updated information within a year. FinCEN has stated it will maintain a registry of this beneficial ownership information, but it will not be public. However, this does not prevent FinCEN from sharing this information with federal, state, local and tribal law enforcement agencies if there is appropriate court approval. FinCEN can also share the beneficial ownership information with financial institutions for customer due diligence purposes, but only with the reporting company's consent.

Second, this NDAA creates a new whistleblower program and establishes a private right of action for whistleblowers who have experienced retaliation. Aiming to incentivize reporting of BSA/AML violations, this program will award whistleblowers who give tips with as much as 30% of the monetary penalties assessed against the company if it leads to monetary penalties over $1 million. This will

depend on the significance of the information, the degree of assistance provided, and the government's interest in deterring BSA violations through these awards. Additionally, a private right of action for whistleblowers who suffer retaliation will be available — whistleblowers can file complaints with the Occupational Safety and Health Administration (OSHA) where, if OSHA fails to issue a decision within 180-days, the whistleblower will be free to file a claim in federal district court.

Third, the Act considerably increases the penalties for BSA/AML violations for both companies and individuals. For repeat violations, additional civil penalties of either (i) three times the profit gained or loss avoided (if practicable to calculate) or (ii) two times the otherwise applicable maximum penalty for the violation are now in play. A new BSA provision will allow for fines "equal to the profit gained by such person by reason" of the violation. It will also include bonuses paid out the year in which the violation occurred or the following year for financial institution directors and employees. Those who have been determined to have engaged in "egregious" violations of BSA/AML provisions may even be barred from serving on the board of directors of a U.S. financial institution for 10 years from the date of the conviction or judgment. Lastly, the Justice Department will, for the next five years, submit reports to Congress on the use of non-prosecution and deferred prosecution agreements during BSA/AML concerns.

The NDAA will also require the Treasury, in conjunction with the Justice Department and other agencies, to evaluate how it plans to streamline SAR and CTR requirements, thresholds and processes. Within one year of the NDAA's enactment, the Treasury must propose regulations to Congress to reduce burdensome requirements and adjustment thresholds accordingly, with the expectation of these threshold adjustments taking place once every five years for the next 10 years.

Fifth, the Act highlights the importance of law enforcement's involvement with international AML issues. FinCEN's mission requires working with foreign law enforcement authorities to safeguard the U. S's financial system. To assist, the Treasury will be required to establish a Treasury Attachés program at U.S. embassies abroad and work with international organizations including the Financial Action Task Force, International Monetary Fund, and Organization for Economic Cooperation and Development to promote global AML frameworks. Additionally, FinCEN will appoint a Foreign Financial Intelligence Unit Liaison at U.S. embassies to engage with their foreign counterparts. Over $60 million per year has been allocated between 2020 and 2024 to the Treasury to provide technical assistance to foreign countries promoting compliance with international standards and best practices for establishing effective AML and counter-terrorist financing (CTF) programs.

Additionally, the NDAA expands financial institutions' ability to share SARs with foreign branches, subsidiaries, and affiliates and requires the Treasury and FinCEN Secretary to create a pilot program to achieve this objective. Currently, financial institutions are only permitted to disclose SARs to foreign affiliates that are a "head office" or "controlling company." This has posed as a roadblock for enterprise-wide compliance within global banks. It is important to note that the Act does prohibit participants in this pilot program from sharing SARs with branches, subsidiaries and affiliates in China, Russia, and other specific jurisdictions.

Lastly, the NDAA significantly modifies the U.S. BSA/AML program in the following areas:

- Introduces several studies relating to (i) artificial intelligence, blockchain and other emerging technologies; (ii) beneficial ownership reporting requirements; (iii) trade-based money laundering; and (iv) money laundering by the People's Republic of China.
- Modifies various definitions relative to virtual currencies and other nontraditional cash substitutes;
- Introduces antiquities dealers (but not art dealers) to BSA's applicable scope;
- Expands ability to subpoena foreign banks' records that maintain correspondent accounts in the U.S.;
- Creates a "FinCEN Exchange" to oversee voluntary public-private information sharing between law enforcement, national security agencies and financial institutions; and
- Envisions a no-action letter process for FinCEN

Apart from these topics, the NDAA reincorporates an emphasis on risk-based approaches to AML program requirements and discusses prior proposed rulemaking from FinCEN. It even includes discussions on the Treasury being required to periodically publish on national AML and CTF initiatives.

There is no doubt that the NDAA's initiatives will be extended over several years and require continued efforts by public and private sectors. The cost of these initiatives to the financial industry and small businesses has yet to be determined and remains a cry of protest from those against the reform. But this does appear to be the start of a more globally-centric effort to combat financial terrorism and money laundering crimes.

Elizabeth K. Madlem Vice President of Compliance Operations and Deputy General Counsel "Elizabeth is the Vice President of Compliance Operations and Deputy General Counsel at Compliance Alliance. She served as both the Operations Compliance Manager and Enterprise Risk Manager for Washington Federal Bank, a $16 billion organization headquartered in Seattle, WA. She has the industry expertise and real-world solutions surrounding bank-enterprise initiatives and knowledge of contract law and bank regulatory compliance. An attorney since 2010, Elizabeth was a Summa Cum Laude, Phi Beta Kappa, Delta Epsilon Sigma graduate of Saint Michael's College in Burlington, VT, and a Juris Doctor from Valparaiso University School of Law in Indiana.

As the Vice President of Compliance Operations, Elizabeth will be overseeing C/A's day-to-day operations of the Hotline and leading our Education initiatives. Elizabeth plays an important part in all operational areas of C/A."

Riding the Liquidity Waves

Dale Sheller, Senior Vice President, Financial Strategies Group, The Baker Group

BEFORE THE COVID-19 PANDEMIC TOOK HOLD ON THE WORLD and the United States, many community bankers watched the slow fall of their on-balance sheet liquidity. Throughout the last decade of economic expansion, many community banks' loan demand consistently outpaced deposit growth. At the beginning of 2020, bankers' expectations for the year were for more of the same: a combination of steady loan growth and an expanding net interest margin. The pandemic completely changed those expectations.

The First Wave

The first liquidity wave in the banking system started gaining momentum in early March as the pandemic sparked fear and panic in the financial markets. The Federal Reserve lowered its benchmark rate by 50bps in early March, only to outdo themselves a couple of weeks later during an emergency meeting with a 100bps cut. Two key things happened in March that started the liquidity wave. First, dollars flowed into the banking system seeking the safety of the FDIC deposit insurance. Second, larger corporations boosted their cash positions and overall balance sheets by drawing on their credit lines.

The wave grew larger in early April as billions in stimulus checks were sent out and the personal savings rate reached an all-time high. Furthermore, the Paycheck Protection Program (PPP) loan program rolled out as part of the CARES Act, which added more liquidity as the initial $349 billion in PPP funds were lent out in under two weeks. While many businesses spent their PPP loan funds over the next two to three months, billions of the loan proceeds sat idle in business operating accounts.

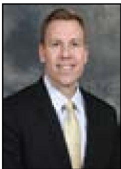
The Impending Second Wave

Where do liquidity levels in the banking system liquidity go from here? Will upcoming loan demand gobble them up, or will there be plenty left over? Outside of additional second draw PPP loans, loan demand remains lower than pre-pandemic levels. Recent PPP loan forgiveness has reduced overall loan portfolios. The additional $2 trillion stimulus package currently moving through Congress includes larger direct stimulus payments, which should further add to overall liquidity levels.

Balance Sheet Considerations

When will loan demand return to a more normal level as seen before the pandemic? One guess is as good as any, but we know that stockpiling cash or short-term liquidity isn't a conservative long-term solution during a historically low-rate environment. Net interest margins compressed significantly over the last year. We need to take a hard look at our short-term liquidity position and ask ourselves if our cash position is too high. Are we waiting too long for loan demand to come back or for deposits to surge out of the bank? It is challenging to predict your liquidity position outside of a few months given all the external factors that can influence it in today's environment.

In 2021, the margin compression fight has shifted more heavily toward maintaining asset yields as most community bankers have cut their cost of liabilities back down to historic lows. If quality loan demand comes back soon, everyone will be ready. However, if deposit growth continues to outpace loan growth, we need to stay fully invested within the bond portfolio. The recent steepening of the yield curve has made bond yields a little more attractive. Yes, we get it; recent bond yields are lower than the good ole days, but remember to compare current bond yields to what holding cash earns (usually around eight-to-10 basis points). The yields on our short-term cash liquidity move in sympathy with the Fed, and it is highly unlikely the Fed will be moving their benchmark rate anytime soon. Since the Fed cut rates back to zero last March and the first liquidity wave began, it has remained costly to sit in too much cash liquidity. The banking environment continues to change rapidly, and it can be a daunting task to keep up; however, staying fully deployed should continue to remain at or near the top of senior management objectives. ◗



Dale Sheller is Senior Vice President in the Financial Strategies Group at The Baker Group. He joined the firm in 2015 after spending six years as a bank examiner with the Federal Deposit Insurance Corporation. Sheller holds a bachelor's degree in finance and a master's degree in business administration from Oklahoma State University. He works with clients on interest rate risk management, liquidity risk management and regulatory issues. Contact: 800-937-2257, dsheller@GoBaker.com.

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April 6-7
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Economic Inclusion and Mobility for all Nebraska Families
April 14
Virtual Offering

School of Banking Fundamentals
April 26-30
Manhattan, KS

MAY 2021

NBA Annual Meeting
May 5
Virtual Offering

JUNE 2021

Operations School
June 8-10
Manhattan, KS

NBA Annual Golf Outing
June 10
Hastings, NE

Call Report Workshop
June 15-16
Virtual Offering

School of Lending Principles
June 21-25
Manhattan, KS

Relationship & Business Development School
June 22-24
Lincoln, NE

JULY 2021

Agricultural Lending School
July 12-16
Manhattan, KS

AUGUST 2021

Young Bankers of Nebraska Conference
August 5-6
La Vista, NE

OCTOBER 2021

NBA Convention "Lite"
October 6-7
Lincoln, NE

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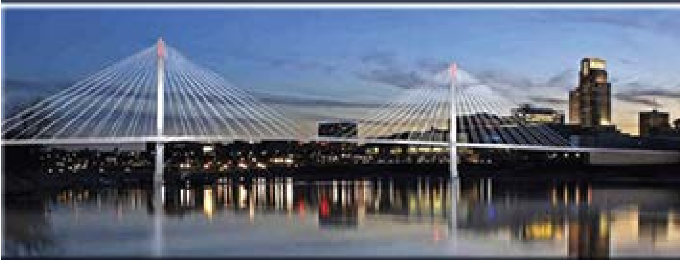

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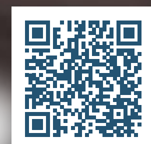

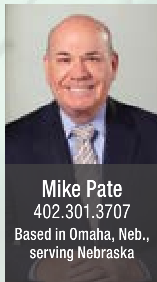

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