Nebraska Banker

NOVEMBER/DECEMBER 2021

NBA Nebraska Bankers Association

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Workforce Strategies

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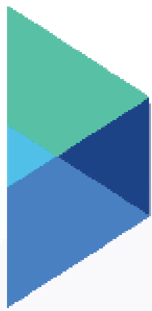

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AS I WAS SITTING DOWN TO FINALIZE MY MAGAZINE column for the month, I received a notice from the Nebraska Department of Labor indicating the state's unemployment rate for September had fallen to 2.0%, tied for the lowest unemployment rate ever recorded by a state. Similarly, the rate in Lincoln had dropped to 1.3%, a record low for the Capitol City.

Every industry in the state, including banking, is facing monumental workforce challenges. Recent NBA analysis suggests Nebraska regularly has over 500 bank job openings. The reality is that the current workforce shortage may not subside for many years! Therefore, it is imperative the banking industry and the NBA think differently about how to attract and retain the best and brightest.

Causes for the lack of workers are varied. For years, demographers warned us about the coming war for talent tied to the mass retirement of the Baby Boomer generation. According to the labor market data company Emsi, in 2020 alone, approximately three million Baby Boomers left the workforce, many of them in highly-skilled and senior-level positions. COVID-19 has also drastically altered the employment landscape. The United States is experiencing a tidal wave of early retirements and a sizable number of people simply leaving the workforce. Finally, rural states like Nebraska have long struggled with the issue of "brain drain." Experts at the University of Nebraska-Omaha Center for Public Affairs Research estimate the state annually loses 2,000 people between the ages of 25 and 35 who pursue career opportunities outside of the state.

To help address these challenges, the NBA is doubling down on its efforts to attend career fairs at colleges and universities, foster meetings with student groups, and create meaningful internships. We are also reevaluating our scholarship and philanthropic efforts. A recent review of the NBA's agricultural banking internship program, for instance, found that around 35% of the more than 150 students who have participated in the program since its inception are still working in Nebraska banks. Almost 40% of the students who have participated in the program over the past three years work at Nebraska banks. Finally, two of the students who participated in the program this past summer have already accepted job offers for June 2022. Our banks have done such a good job training these students that even our competitors at Farm Credit are actively try to recruit these young finance/banking leaders. (Watch the NBA E-Update or reach out to Kara Heideman on our NBA team to find opportunities for your bank to engage with students and internship opportunities.)

While a sizable number of Nebraskans have traded in their full-time jobs for retirement or to pursue less structured opportunities, I would suggest that these individuals should be a primary recruitment target, assuming your institution is willing to be flexible. Not everyone is built for retirement; my dad retired three times. He liked to work so much that he actually worked part-time up until three weeks before

his health got the best of him. I suspect there are bankers out there who share this desire to keep working even during retirement. Go get ‘em! I am also aware of a number of young mothers who are interested in part-time professional opportunities. Consider matching these individuals and offering a full-time shared position. While this may take some extra coordination on the bank’s human resource team, it is an efficient way to secure excellent employees who are committed to the bank.

Offutt Air Force Base in Bellevue is home to more than 8,000 military members. Each year, a sizable number of these individuals transition or retire from the military. To help service members with this transition, the Department of Defense offers the SkillBridge program that allows active-duty military personnel to spend the last 180 days of their military service interning at a civilian job. Additionally, participating companies are asked to coordinate a structured “educational work” experience allowing transitioning service members to evaluate careers. Participants continue to receive military pay and benefits and are not paid by the sponsoring company. Even if your bank is outside the Omaha metro area, you can participate in the SkillBridge program. In addition to educational and employment services for military members, the Department of Defense Spouse Education and Career Opportunities program provides career services for military spouses, including the Military Spouse Employment Partnership job network.

Finally, remote work opportunities have evolved as a mainstream workforce strategy, thanks in large part to the pandemic. Nebraska banks have historically been recognized for offering flexible work environments, with many institutions focused on “family first.” Clearly, not every position within a bank can be performed remotely, but COVID-19 allowed the industry to identify positions that could be offered with even greater schedule flexibility. The NBA team has talked recently with several banks that plan to keep a portion of their team members in a hybrid model. Further, I have talked with bank leaders who now rely upon key managers who work entirely remotely. There is no question that remote flexibility creates significant challenges and opportunities, with a sizable number of unknown factors. However, current times may require new strategies and priorities.

Again, I encourage you to throw out your traditional view on the workforce and begin to think about how the future will look different. The NBA will be your partner as we move through these challenging times together. ◗

Contact Richard Baier at (402) 474-1555 or richard.baier@nebankers.org.

The Impact of an Internship

GROWING UP ON A FARM NEAR ARLINGTON, KRISTA PRINZ WAS HEAVILY involved in 4-H and FFA. When it came time to choose a college major, the ag banking and finance option of the agribusiness major at the University of Nebraska-Lincoln (UNL) was a natural fit. The major includes both traditional finance classes and courses with an emphasis on agriculture. Students in the program are eligible to receive a scholarship and complete an internship at a Nebraska bank. The program is a partnership of the NBA and UNL and is designed to fill the need for ag bankers in Nebraska.

Prinz, currently the president of Citizens State Bank in Wisner, has worked in banking since completing her internship through the program in 2008. She credits her internship and the program’s curriculum with providing a solid banking foundation. Prinz has helped provide opportunities for future ag bankers by mentoring program interns at her bank. Banks are also able to reap a variety of benefits from the program. ◗

Learn more about internships and how your bank can build the future banking workforce by visiting nebankers.org/interns.

To Pay or Not to Pay:

Ransomware Attacks Offer an Unsavory Choice

Rob Nichols, President and CEO, American Bankers Association

IT'S THE MESSAGE A CEO NEVER WANTS TO RECEIVE: "WE'VE GOT your data and you need to pay up if you want it back."

Unfortunately, that message is landing in CEO inboxes increasingly often, as ransomware attacks ramp up in the U.S. In just the first six months of 2021, the Financial Crimes Enforcement Network identified $590 million in ransomware-related Suspicious Activity Reports — a 42% increase from the 2020 total of $416 million. And FinCEN reports that we could be on track to see a higher transaction value for ransomware-related SARs than we've seen in the past 10 years combined.

Ransomware attacks — which use malware to encrypt files on a computer or mobile device and render it unusable until a ransom is paid — present companies with an unsavory dilemma: pay a ransom to a criminal actor, or lose a potentially devastating amount of data, which could seriously compromise business operations.

These kinds of attacks are evolving quickly in sophistication and scope, and virtually any business could be targeted at any time. What's perhaps most concerning is that criminal actors are increasingly targeting critical infrastructure entities, as we saw in the Colonial Pipeline incident earlier this year that caused a shutdown of a major East Coast oil provider. They've also begun branching out into "extortion-ware," in which the hacker not only encrypts sensitive data but then goes the extra step and threatens publicly to release it unless the institution complies with their demands.

Given the potential operational and reputational consequences of these types of cyberattacks, banks need to have a plan in advance for how they'll respond. There are a number of factors to consider.

First, while most companies choose to pay — cyber insurer Marsh McLennan reports that more than 60% of ransomware victims pay the requested ransom — it's not

always guaranteed that the encrypted data will be fully restored. In fact, one survey of more than 5,000 I.T. decision-makers worldwide found that about half of those who did pay a ransom only recovered 65% of their compromised data. Twenty-nine percent said they only recouped about 50%.

And even if a company's ransom hacker unlocks all the encrypted data after the ransom is paid, the company will still need to take steps to clean that data and ensure it can't be easily re-encrypted.

On the other hand, there are also several good reasons not to pay a ransom. There are the societal costs to consider — paying the ransom could perpetrate attacks on other institutions or entice the hacker to hit you again for more money. Paying a ransom could also erode trust from customers and business partners, as payment could signal a lack of continuity planning and preparation.

Either way, the first time you think about ransomware attacks and how to handle them should not be after your bank has fallen victim to one. To that end, ABA in October released a new Ransomware Toolkit, which provides helpful guides for protecting your bank against ransomware attacks, responding in the event of an attack, and determining whether to pay a ransom. The toolkit can be downloaded at aba.com/ransomware.

Ransomware represents a serious threat to all businesses. But the good news is that the financial sector is ahead of the game when it comes to cybersecurity, given the rigorous regulatory framework to which banks adhere. After all, as we found in a recent ABA/Morning Consult poll, consumers overwhelmingly trust banks the most to keep their personal information safe and secure.

By addressing the problem of ransomware head-on and taking prudent steps to prepare, we can help our industry maintain its reputation as the "gold standard" for data protection.

Email Rob Nichols at rnichols@aba.com.

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A Victory for Secured Lenders:

Nebraska Supreme Court Confirms a Secured Lender's Right to Collect Its Borrowers' Accounts Upon Default

Brian Barmettler, Nicholas Buda and Brandon Tomjack, Baird Holm, LLP

LENDERS OFTEN REQUIRE THEIR borrowers grant them a security interest in their accounts in order to secure the borrowers' loan obligations. Accounts are arguably one of the most liquid types of collateral available to secured lenders and can sometimes lead to substantial recovery for lenders when loans go bad.

Although the creation, attachment, and perfection of a security interest in accounts are fairly straightforward under the Nebraska Uniform Commercial Code (the "UCC"), foreclosing accounts is no easy task. You cannot send the sheriff or your local repo agent to collect a third-party's legal obligation to pay your borrower. Fortunately, the Nebraska Supreme Court recently confirmed a secured lender's right to collect its borrower's accounts and identified the applicable requirements and procedures in its decision of First State Bank Nebraska v. MP Nexlevel, LLC, 307 Neb. 198, 948 N.W.2d 708 (2020). But, as discussed below, the path to the decision was riddled with a puzzle of complicated statutory language and lender-hostile precedents from other jurisdictions.

The Facts of the Case

The case transpired like many familiar loan transactions. The bank loaned money to Husker Underground, a local construction business, and Husker Underground granted the bank a security interest in essentially all of its assets. In particular, Husker Underground granted the bank a security interest in its accounts: money third parties owed the debtor for construction services Husker Underground had performed.

The bank properly perfected its security interest in Husker Underground's accounts by filing a financing statement with the Nebraska Secretary of State. A few years later, Husker Underground stopped making loan payments, and the bank declared Husker Underground in default. Upon Husker Underground's default, the bank began exercising its remedies to collect Husker Underground's obligations.

The bank liquidated its collateral to minimize losses, including Husker Underground's accounts. Among other things, the bank attempted to liquidate Husker Underground's accounts, as set forth in Part 6, Article 9 of the UCC. It sent deflection notices to one of Husker Underground's account debtors — a company that owed Husker Underground money for construction projects — and demanded the account debtor pay all amounts due on the accounts directly to the bank instead of Husker Underground.

One of Husker Underground's account debtors, MP NexLevel, ignored three of the bank's deflection notices. Despite the warning in the bank's notices indicating there may be adverse consequences for MP NexLevel if it continued to make its payments to Husker Underground rather than the bank, MP NexLevel paid Husker Underground more than $400,000 after receiving the bank's notices. As a result, the bank filed suit against MP NexLevel to recover the amounts paid by MP NexLevel to Husker Underground after the bank sent its deflection notices.

The District Court Decision

MP NexLevel was not involved with the bank's loan to Husker Underground and did not have any agreements with the bank. MP NexLevel's contract

was with Husker Underground, not the bank. What legal obligations did MP NexLevel owe to the bank? The law governing this matter is a complicated web formed by various sections of UCC Article 9.

First, after a debtor's default, UCC §9-607(a)(1) allows a secured lender (the bank) to send deflection notices to its debtor's (Husker Underground) account debtor (MP NexLevel), demanding the account debtor pay all amounts due on the account directly to the secured lender. Importantly, this section of the UCC does not create an independent duty owed by the account debtor to the secured lender; instead, any obligation the account debtor owes the secured lender is based on the agreement between the debtor and the account debtor.

Second, once an account debtor receives a valid deflection notice from a secured lender, the account debtor may only discharge its account obligations by paying the secured lender instead of the debtor according to UCC §9-406(a).

Third, in the event an account debtor ignores a secured lender's deflection notices and continues paying the debtor, the account debtor has failed to discharge its payment obligations on the accounts. At that point, UCC §9-607(a)(3) allows a secured lender to step into its debtor's shoes and sue the account debtor to enforce the account debtor's payment obligations on the account.

When MP NexLevel ignored the bank's notices, the bank stepped in to Husker Underground's shoes and sued MP NexLevel for breach of contract to collect the more than $400,000 still due on the account, even though MP NexLevel had already paid these amounts to Husker Underground. The bank requested the district court to enter judgment in its favor, but the district court declined. The district court based its ruling on the text of UCC §9-406(a), which uses the word "assignment" and "assignee" rather than "security interest" and "secured creditor." The district court held that only creditors with outright assignments of their borrowers' accounts can use UCC §9-406(a) to enforce those assignments, but it does not apply to secured lenders with security interests in accounts. Since the bank had a security interest — not an outright assignment — the district court dismissed the bank's case. The district court's decision essentially stripped the bank of its security interest and left the bank without any option to collect over $400,000 of its collateral.

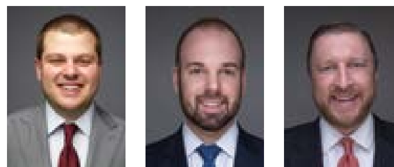
The Supreme Court's Decision and the Law

The bank appealed the district court's decision to the Nebraska Supreme Court, which reversed the district court. Relying on principles of statutory interpretation presented by the bank's counsel, the Nebraska Supreme Court held there is no meaningful distinction between an "assignment" and a "security interest" for purposes of UCC Article 9 and a secured lender's right to enforce its security interest in accounts. The Nebraska Supreme Court's ruling confirms a secured lender can enforce a security interest in its debtor's accounts similar to other tangible personal property, such as equipment and inventory.

The First State Bank Nebraska Court summarized the enforcement of security interests in accounts this way: Following a default — a term Article 9 leaves for the parties to define in their loan documents — the secured lender sends a notice directly to the account debtor instructing the account debtor to pay the secured lender directly. The account debtor may ask for proof the secured lender has a security interest in the account at hand. In most cases, the proof consists of the lender's security agreements and other loan documentation showing the debtor is in default. Once the secured lender has provided satisfactory proof of its security interest or the account debtor failed to request such proof, the account debtor can only discharge its obligations on the account by paying the secured lender. The account debtor that opts to ignore the notices and continues paying the debtor is not discharging its debts on the account. In turn, the secured lender can step into its debtor's shoes to enforce the account debtor's payment obligations on the account.

The Nebraska Supreme Court correctly interpreted UCC Article 9. Any contrary ruling would have been inconsistent with the UCC's comprehensive regulation of security interests in personal property, such as accounts, and had disastrous consequences for secured lenders who rely upon accounts as an important type of collateral. Were UCC §9-406(a) only to apply to "assignments" of accounts instead of security interests, many secured lenders would be without any avenue to legally require an account debtor to turn over funds due on an account. Instead, the Nebraska Supreme Court wisely ruled that the "assignee" in UCC §9-406 included a secured creditor with a presently exercisable security interest in its debtor's accounts. First State Bank Nebraska, 307 Neb. at 220, 948 N.W.2d at 725. For Nebraska lenders, the decision confirms accounts are valuable collateral that a secured creditor has the legal right to collect when the lender is enforcing its rights and remedies under Article 9 of the UCC.

By Brian Barmettler, Nick Buda and Brandon R. Tomjack of Baird Holm. For more info visit, bairdholm.com.



Controls to Reduce Vendor Breach Risk

Cody Delzer, CISA, CDPSE, SVP IS Consultant/Regional Director, SBS CyberSecurity, LLC

THE THOUGHT OF A VENDOR BREACH IS terrifying. We engage in vendor relationships because the value proposition is that the vendor will provide us better service and security than we can provide for ourselves, often at a lower cost than we would incur to perform and secure the service for ourselves. We put immense trust in our vendors, yet the news is riddled with stories of data breaches involving trusted vendors.

So, where do we start? What do we do?

Modern vendor management requires a contemporary approach to controlling risk. The following controls, when implemented properly, will reduce a significant amount of risk:

- **Multi-Factor Authentication (MFA)** — MFA is the single greatest risk-decreasing control you can implement in your organization. Use it whenever and wherever possible, but it must be on all internet-facing apps. The rule of thumb is this: if an application can be accessed outside of your network (i.e., VPN, email, or web portal access), get MFA on ASAP.

- **Strong Password Requirements** — Even with MFA in place, a strong password is still a must, as it'll guarantee protection against hackers and malicious software. Also, MFA isn't always feasible on all applications, so a complex password will double the security.

- **Religious Patch Management** — If you have a system with software, you NEED to be patching

religiously. Falling behind on patches leaves systems vulnerable to known attacks that can be prevented with proper patching.

- **Follow the 3-2-1 Data Backup Rule** — The 3-2-1 Backup Rule is highly recommended for any organization looking to back up their data. This methodology suggests keeping three (3) copies of your data on two (2) different forms of media and one (1) of those copies being off-site.
- **Network Segmentation** — The greater the segmentation, the harder it is for an attacker (or malware) to move throughout your network.
- **Egress Firewall Filtering** — Firewalls, by default, block everything coming in and permit everything to go out. You gain significant control over what resources your internal systems can access when egress filtering is enabled.

Here are a few additional tips to help control risk:

- **Log the right activity and establish a baseline on your network**. Anything outside of the baseline could be an indicator of compromise. Ensure you have some central logging capability. Central logging capability is not SIEM. It is a place for you to store your collected logs. Make sure this system is a bastion host. Its data may be key in an investigation.

> Modern vendor management requires a contemporary approach to controlling risk.

- **Have separate user accounts**. The ultimate rule is that one user means one account and allows for accountability. All users should be restricted users, especially vendors. If a user is also an administrator, ensure they have a separate, privileged account to perform those administrative tasks. Ensure no one uses service accounts. Service accounts are often administrative in nature.

  Confirm each service that needs a service account has its own service account, like how individual

Tech Talk — continued on page 16

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What is really covered? What do insurance companies expect from your cybersecurity controls paying the claim? Does your coverage include incident response and digital forensics costs? Ask questions, explore the options. The insurance companies are more than willing to help.

Tech Talk — continued from page 15

users have their own user accounts. Remember, it's about accountability.

- **Familiarize yourself with an incident response preparedness checklist**. The list should highlight what organizations must have in place ahead of time to ensure the ability to respond to an incident quickly and perform a digital forensics investigation should the need arise.
- **Get cybersecurity insurance**. If you haven't already gotten it, please investigate it. Unfortunately, it is a tricky subject since there is no standard. If you haven't gone down the path of obtaining cybersecurity insurance, ensure you understand the following: What is really covered? What do insurance companies expect from your cybersecurity controls paying the claim? Does your coverage include incident response and digital forensics costs? Ask questions, explore the options. The insurance companies are more than willing to help.
- **Familiarize yourself with legal, and not just your legal counsel, but law enforcement**. Understand what their capabilities are and what they can provide in an event. Engaging your legal team can help protect your organization, especially if an investigation is needed, and it usually is. Ensure you run all communications through your legal team. Engage with law enforcement. Legal counsel and law enforcement will work with you to determine when to notify customers.

Now that you've read a few tips, take a moment to assess your cybersecurity practices.

Can you afford not to control unauthorized access to your valuable data? If you can't take the appropriate steps to secure your organization now, will you be able to act later as the threat landscape continues to escalate?

Implementing the controls discussed in this article will push your vendor management practices and overall cybersecurity risk mitigation into the stratosphere. It is less expensive to start implementing these controls today versus waiting until an incident occurs, leaving you with the costly decision to implement these controls.

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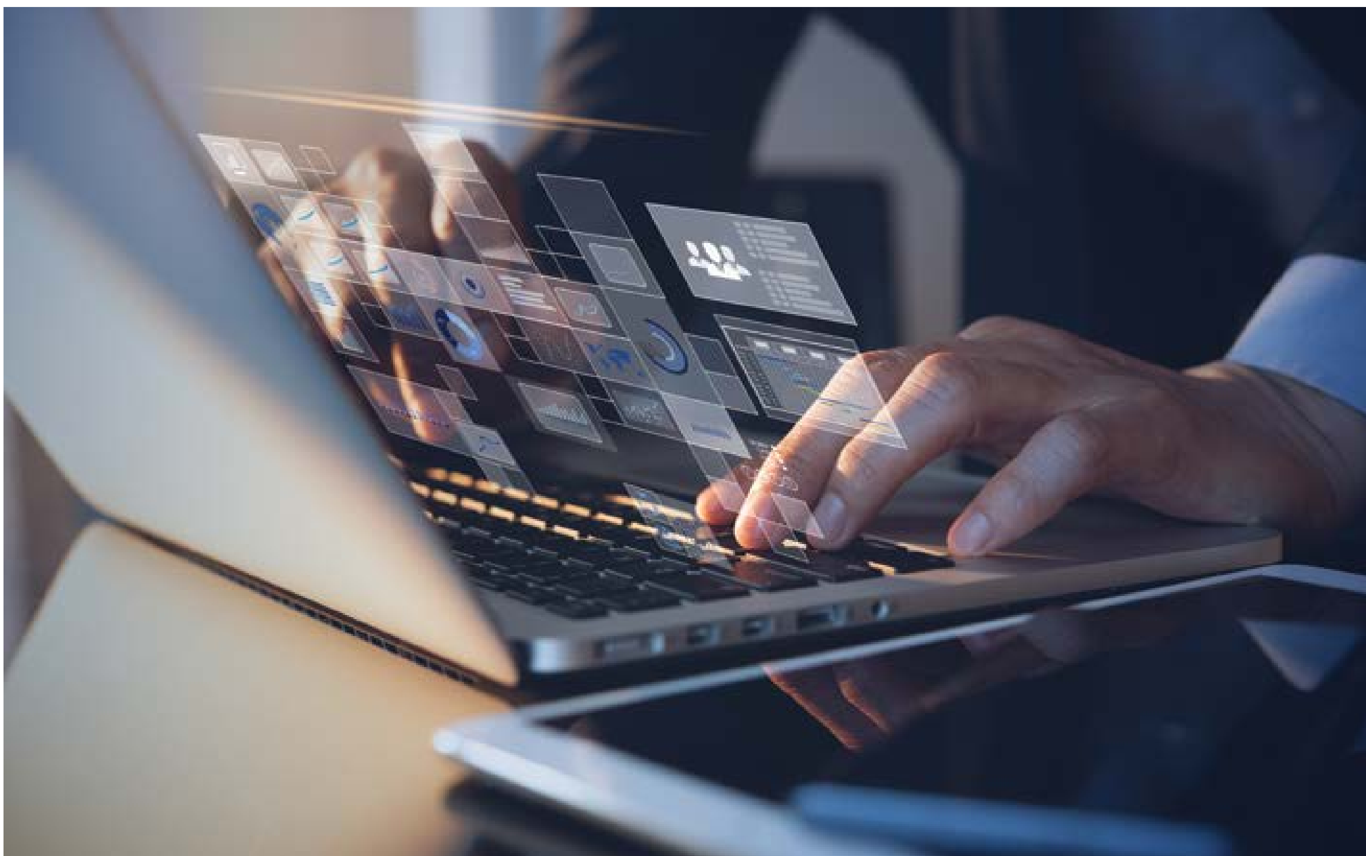
OCC Releases Proposal to Rescind CRA Final Rule After a False Start

Chris Bell, Associate General Counsel, Compliance Alliance



NEW LEADERSHIP USUALLY TAKES US INTO THE FUTURE. The Office of the Comptroller of the Currency (OCC) is reversing this trend by first taking us into the past for a bit. Seeing the June 5, 2020, final rule to modernize its Community Reinvestment Act (CRA) framework (June 2020 Rule) as a false start, the OCC has issued a proposed rule to rescind it in favor of working with the other agencies to develop a new rule. The proposed rule would replace the existing 12 CFR part 25 with a revised 12 CFR part 25 based on the 1995 Rules and reinstate 12 CFR part 195 (for savings associations). The proposed 12 CFR part 25 would be substantively identical to the 1995 rule. All definitions, performance tests and standards, and related data collection, recordkeeping, and reporting requirements would revert to those in place before the OCC issued the June 2020 Rule. Also, the rules surrounding the public file and public notice requirements would revert to those in the 1995 rule. The proposed rule applies to all national banks and all federal and state savings associations. If you would like to comment on any aspect of the proposal, you must submit those before Oct. 29, 2021. The June 2020 Rule would remain in effect until replaced by final rules based on this proposal.

The OCC recognizes that banks have relied on the June 2020 Rule to plan for their ongoing compliance with the CRA. Given the partial implementation of the June 2020 Rule, its replacement would change the regulatory framework that impacts, among other things, how examiners evaluate banks and what qualifying activities they would consider

in CRA examinations. The OCC proposes a transition to replace certain aspects of the June 2020 Rule, which it summarizes in a chart on Page 38 of the proposed rule (https://www.occ.gov/news-issuances/federal-register/2021/nr-occ-2021-94a.pdf). Subsequently, as part of the ongoing interagency CRA rulemaking, the OCC would propose a joint revised CRA rule to replace the rules in this proposal. Following publication of any final rules regarding this proposal, banks would have a minimum of 30 days before they would be required to comply with most of the provisions described in the proposed rule. Therefore, the OCC is considering an effective date of Jan. 1, 2022, for any final rules, provided they are published by Dec. 1, 2021.

Banks that changed type based on the asset threshold adjustments in the June 2020 Rule are subject to different performance standards for activities conducted on or after Oct. 1, 2020. Also, former "large banks" that became "intermediate banks" under the June 2020 Rule were no longer required to collect data for calendar year 2021 onward and report data for calendar year 2022 onward. Many of these banks will transition back to their prior bank type based on the proposed asset-size thresholds. Consistent with its historical practices, if the proposed rules take effect Jan. 1, 2022, the OCC would require newly-classified large banks to begin collecting data Jan. 1, 2023, and reporting required and optional data the following year. The OCC will not provide banks transitioning from small banks to Intermediate Small Banks (ISB) to transition to the ISB performance standards. However, the OCC would consider the change in bank type as part of the bank's performance context when evaluating the bank's CRA performance.

The OCC proposes that OCC-regulated banks would receive consideration in their CRA examinations for activities that met the qualifying activities criteria or definitions that were in effect when the bank conducted those activities. The OCC will maintain the illustrative list of qualifying activities on its website to help banks determine whether the activities they performed while the June 2020 Rule was in effect are eligible for CRA consideration. However, activities included on the illustrative list may not receive consideration if conducted after the effective date of the final rules.

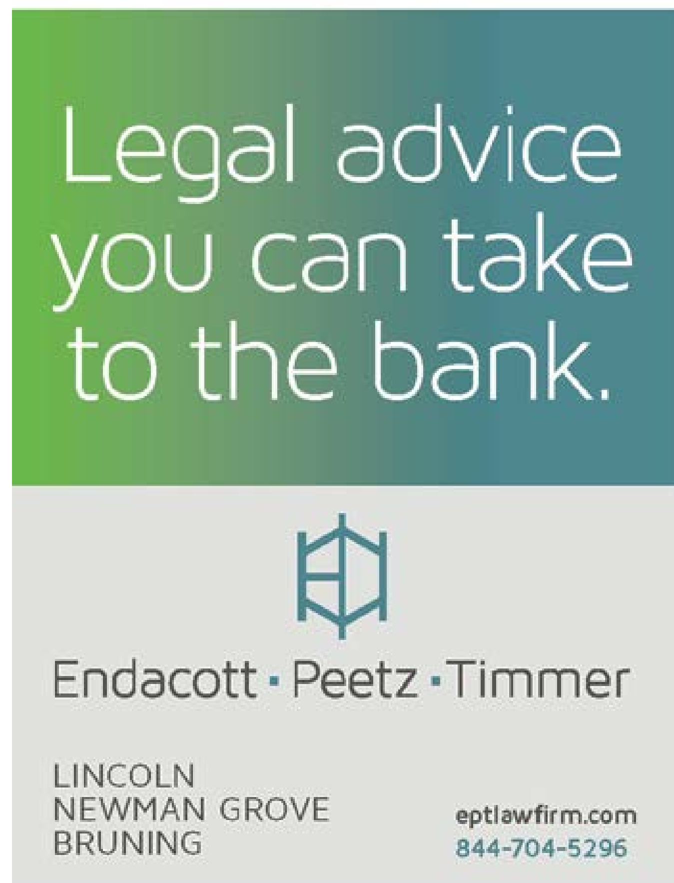
The June 2020 Rule changed the public file requirements by reducing the information required in the public file and changing the requirements for how an OCC-regulated bank makes the public file available to the public, including permitting these banks to make the public file available solely on their websites. Under the proposed rules, banks would need to include additional information in their public file and make the file available at their main office. Interstate banks must make their public file available at one branch in each state and more limited information at each branch.

Since the proposed rules would impose additional public file content and availability requirements, the OCC expects to provide in the final rule that banks would comply with these requirements no later than three months after the final rule's effective date.

The June 2020 Rule permitted banks to include target market assessment areas when requesting approval for a strategic plan. The OCC proposes maintaining any strategic plans approved by the OCC under the June 2020 Rule and would not require these banks to amend their strategic plans.

Chris W. Bell serves as Associate General Counsel for Compliance Alliance. He holds a bachelor's degree in Political Science from the University of Memphis, a master's degree in Political Management from the George Washington University, and a law degree from the St. Mary's University School of Law.

Chris began his career working for a regional bank in Tennessee, where he developed a passion for serving customers through the banking system. In law school, Chris focused his studies on the different financial aspects of the law, including the Internal Revenue Code and Uniform Commercial Code. Chris has worked in the legal department of a federal savings bank and for the Texas Department of Banking. As one of our hotline advisors, Chris helps C/A members with a wide range of regulatory and compliance questions.



Checking In on the Banking Industry

Dale Sheller, The Baker Group

2020 WAS A YEAR OF CHALLENGES IN MANY ASPECTS OF LIFE, business, and the economy. The start of 2021 brought a close to a tumultuous year and opened the door to a year of economic recovery and hope for more normal times. In March 2020, the banking industry was rocked when the Fed funds rate was cut to zero at an unprecedented speed, and Treasury yields tumbled to all-time lows. Additionally, the massive influx of stimulus-related deposits that flowed into the banking system greatly changed the size and structure of balance sheets. As a former bank examiner, I am taking a chapter from my previous regulatory career by looking at the banking industry as it relates to the Uniform Financial Institutions Rating System and its six components, known as CAMELS.

Capital — A wise person once told me that capital cures a lot of ills. While this statement is very true, not properly leveraging your capital may leave some additional earnings and shareholder returns on the table. Before the pandemic hit, leverage ratios were very strong, with only 14 banks on the "less than well-capitalized" list. For the most part, leverage ratios haven't been stressed in the traditional sense with loan losses; however, many institutions have seen a reduction in their leverage ratios as asset growth has dramatically outpaced capital growth. Additional pressure on leverage ratios could continue throughout 2021.

Asset Quality — This is likely the biggest unknown of all the components. When the COVID-19 pandemic forced

As a former bank examiner, I am taking a chapter from my previous regulatory career by looking at the banking industry as it relates to the Uniform Financial Institutions Rating System and its six components, known as CAMELS.

many states to shut down to varying magnitudes, many businesses struggled, and millions lost their jobs. As we continue the second half of 2021, the delta variant is pushing its way throughout the country, but in general, we haven't seen massive asset quality problems materialize. Asset quality is likely to vary significantly from bank to bank and region to region. Some institutions have more exposure to the most hard-hit industries, while others have little to no exposure. We know that extensions, deferrals, and government stimulus have propped up some businesses and kept loans from going bust. Time will tell which businesses and customers will be able to get back on their feet and which won't.

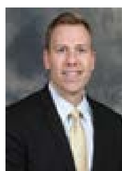
Management — Management is easily the most subjective component of all the CAMELS components. Bank management has been extra busy with the many challenges being thrown their way due to the pandemic. Community banks have continued to shine bright, providing us a friendly reminder of just how important they are to the communities of this country.

Earnings — The industry was riding high in 2018 and 2019 after record years of profitability through expanding net interest margins, low provision expenses, and lower tax rates. However, zero-bound short-term interest rates, combined with high levels of low earning cash liquidity, have put margins back under pressure. The average community bank has seen significant margin compression in 2020 and 2021. In 2020, many institutions were aggressive in providing for their allowance for loan losses, given the uncertainty of the economy throughout the year. Going forward, many predict low-interest rates are here to stay; therefore, some level of margin compression will likely continue. Many banks are likely well reserved against future loan losses, and the absence of more near-term provision expenses will be welcomed.

Liquidity — Higher loan-to-deposit ratios and less on-balance sheet liquidity were the consistent themes for many institutions over the last several years; however, the pandemic quickly changed them. A combination of massive government stimulus via direct payments and the PPP loan program, coupled with higher personal savings rates and a flight to quality, boosted the industry's deposit base and overall liquidity picture extremely fast. Institutions are now flush with more liquidity than they have been in years, and this excess liquidity doesn't seem to be going away anytime soon. Having excess on-balance sheet liquidity 18 months ago was generally a good thing as loan demand was consistently outpacing deposit growth. The pandemic has completely flipped that narrative. Excess liquidity is now the enemy, with short-term interest rates near zero and a lack of loan demand (outside of PPP loans) plaguing the industry.

Sensitivity to Market Risk — Once the financial crisis sent short-term rates to zero, most bank examiners tended to associate interest rate risk only if interest rates increased. However, the pandemic quickly reminded us that most banks perform better when interest rates rise. During a rising rate environment, the economy experiences growth and expansion, and margins tend to expand due to stronger loan demand, higher loan and bond yields, and deposit costs that lag market rates. Institutions spent most of the last decade preparing their balance sheets for rising interest rates; therefore, they were not as well prepared for the pandemic-induced zero interest rate environment. Margins contracted hard and fast in 2020 and are currently at historic lows. Today, the vast majority of institutions are well-positioned for rising interest rates as their stockpiles of short-term liquidity have pushed them even further asset-sensitive than before. As we find ourselves near historically low-interest rates, we must remind ourselves that the risk of rates not rising is a risk not to ignore.

Bank balance sheets have been dealt a tough hand with all the deposits flowing into the banking system at historically low-interest rates. Community banks have once again shown their resiliency during tough times and will continue to push forward.



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. He can be reached at 800-937-2257 or dsheller@GoBaker.com.

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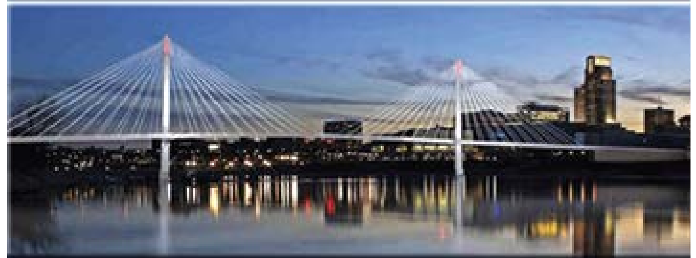

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EDUCATION CALENDAR

Due to COVID-19, event schedules are subject to change. Please visit nebankers.org/education.html or call the NBA Education Center at 402-474-1555 for the most current event schedule.

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The Three C's for Managing Unconscious Bias Workshop
January 13
Virtual Offering

State Government Relations Forum
January 27
Lincoln, NE

FEBRUARY 2022

Operations Conference – Technology, Marketing, Retail Banking
February 8-9
Lincoln, NE

Mid-Winter IRA Workshop Series
February 14-15
Lincoln, NE

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February 16-17
North Platte, NE

Health Savings Account Seminar
February 18
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Principles of Banking Seminar
February 23-24
Virtual Offering

Bank Executives & Directors Conference
February 27 – March 3
O'ahu, HI

MARCH 2022

Supervisor Bootcamp Conference
March 15-16
Lincoln, NE

Tri-State Conference
March 29-30
Overland Park, KS

APRIL 2022

Spring Agri-business Conference
April 5-6
Kearney, NE

MAY 2022

NBA Annual Convention
May 4-6
La Vista, NE

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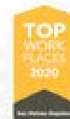

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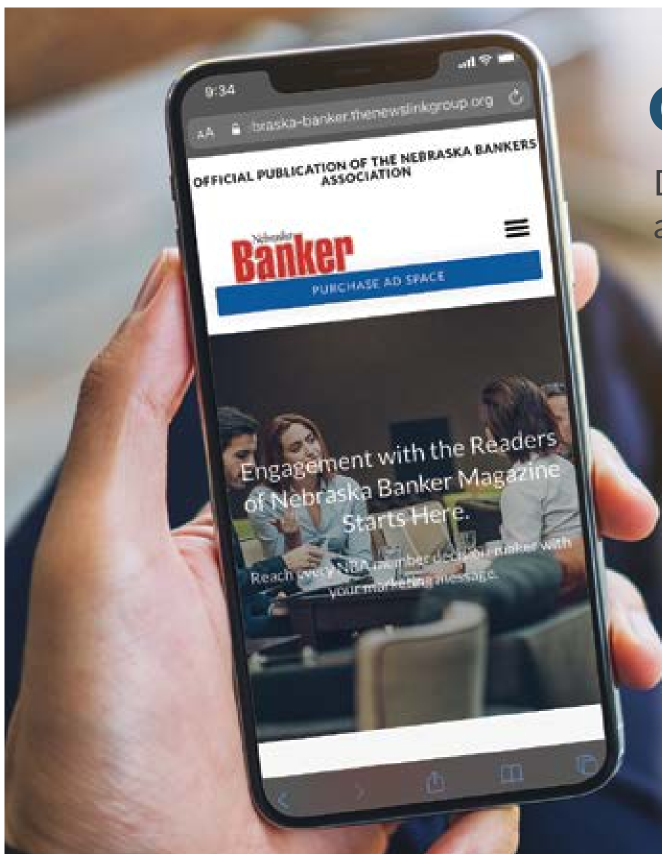

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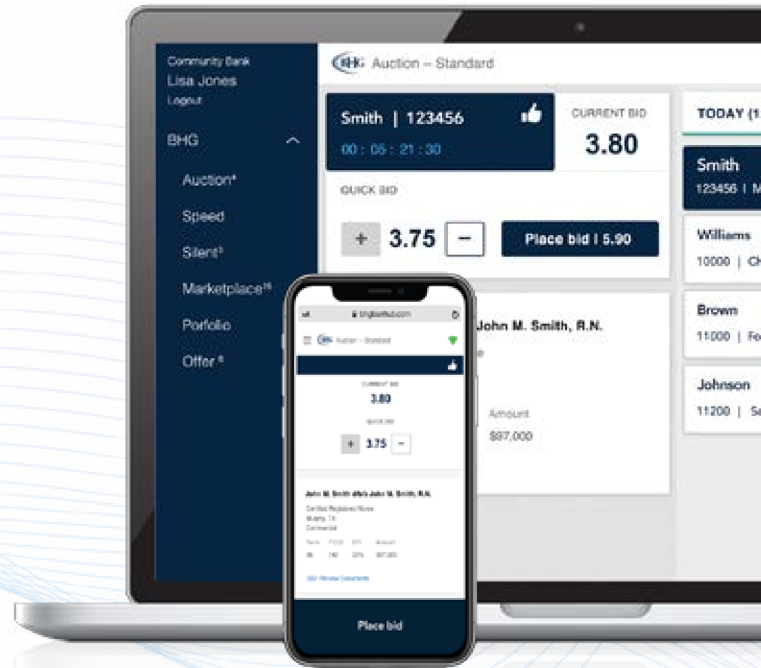

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