



Nebraska
Banker

MAY/JUNE 2022

NBA Nebraska Bankers Association

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TO WATCH
FOR IN 2022**

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MAY/JUNE 2022

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SUBSCRIPTION: Subscription to the magazine, which began bimonthly publication in May 2006, is included in membership fees to the NBA.

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(402) 363-7411
Cornerstone Bank
York

KELLY TRAMBLBY

(402) 756-8601
South Central State Bank
Campbell

DONALD JIVIDEN

NBA EDITORIAL STAFF

RICHARD BAIER

NBA President and CEO
richard.baier@nebankers.org

KARA HEIDEMAN

Director of Communications
and Marketing
kara.heideman@nebankers.org



233 South 13th Street, Suite 700
Lincoln, NE 68508
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JUNE 2022

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2022 New Account Documentation & Compliance Workshop

July 26-27
Virtual

Real Estate Compliance Lending Conference

August 16-17
Lincoln, NE

JULY 2022

Agricultural Lending School

July 11-15
Kearney, NE

AUGUST 2022

Young Bankers of Nebraska Conference

August 4-5
Omaha, NE

Bank Compliance School

August 22-26
Kearney, NE

BSA/AML Compliance Management Workshop

July 19-20
Virtual

Call Report Workshop

August 9-10
Virtual



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2022 NBA Annual Convention Recap

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



AFTER AN EXTENDED PANDEMIC PAUSE, IT WAS AN ABSOLUTE pleasure to see so many bankers, vendors and friends at the 2022 NBA Annual Convention in early May at the Embassy Suites in La Vista. The Convention program included a number of excellent speakers, awards presentations in several bank and educational categories and a highly visible gubernatorial forum which included all the leading candidates for Nebraska's governor.

Each year, the NBA conducts an Annual Membership Meeting as part of Convention. During the meeting, members receive an organization report and vote on incoming board and chair nominees. Congratulations to Stephen Stull, Nebraska Bank, Hickman, on his election as Chair of the NBA. Lydell "Woody" Woodbury, First Nebraska Bank, Valley, was approved

as Chair-Elect. Special thanks to Kirk Riley, Waypoint Bank, Cozad, who completed his service as Chair of the NBA.

For those of you who were unable to attend Convention, I thought I might share a few highlights from the 2021-22 NBA Annual Report:

1. Membership remains strong, with 162 bank members, 87 associate members and 25 preferred vendors.
2. The NBA remains financially sound with \$5.89 million in assets and \$577,000 in liabilities. Total member equity is estimated at \$5.3 million. Fiscal year-end estimates for April 30, 2022, indicate revenues in excess of expenses of approximately \$320,000.

3. Your NBA education team hosted 28 virtual and in-person educational events which were attended by more than 2,200 Nebraska bankers. The NBA also graduated its 13th Leadership Class.
4. Through its philanthropic efforts, the NBA continued to invest heavily in support of education and workforce development. Scholarship and higher education investment totaled more than \$182,000.
5. A new NBA job board was rolled out which promoted more than 400 job openings across our state.
6. Communications upgrades included an updated website with new navigation and search capabilities. Similar updates were completed for other NBA communications platforms, including the weekly Update newsletter and growing social media effort.
7. Advocacy at the state and federal level remained a strategic priority. In the Nebraska Legislature, your NBA team helped shepherd five legislative bills across the finish line. Federally, NBA members responded with more than 920 calls to members of Congress when they pushed plans to force banks to report all transactions in excess of \$600 to the IRS. Finally, your NBA legal team aggressively led objections to the proposed purchase of Premier Bank in Omaha by Iowa-based GreenState Credit Union.
8. Total NBA Political Action Committee (NBA BankPAC) contributions exceeded \$152,000, allowing the NBA to play a key statewide role in supporting candidates for elected office who are pro-banking and pro-business.
9. Approximately 85% of the banks in Nebraska are enrolled in one of the Voluntary Employee Benefits Association (VEBA) group insurance programs, representing more than 10,000 covered lives. Similarly, Agency Services worked cooperatively with 100 bank-owned insurance agencies across the state.
10. New initiatives like the Single Bank Pooled Collateral Program continue to excel with 20 banks participating, covering more than \$1.9 billion in public deposits.

None of these organizational successes could be accomplished on behalf of you, our members, without an amazing team of highly dedicated and professional staff. I want to personally thank the dedicated NBA, NBISCO, Schools of Banking and VEBA staff members who work tirelessly every day to support the bank industry in Nebraska.

Lastly, thank you for your continued support and investment in the NBA. Together, we can collectively help the banking industry thrive and prosper in the Cornhusker State. ▶



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Rethinking “The Great Resignation”

Rob Nichols, American Bankers Association



A MERICAN WORKERS ARE QUITTING THEIR JOBS IN RECORD numbers – leading economists and pundits to dub the period we’re currently living through “the Great Resignation.”

According to the Society for Human Resource Management, employees exited their jobs in record numbers over the 10 months between March and December 2021, and the Federal Reserve continues to report ongoing labor shortages nationwide. As of February, there were 11.3 million job openings in the U.S., according to the Labor Department.

For many workers, the pandemic prompted the desire to change jobs or careers – a massive period of upheaval that led them to rethink what they wanted and needed in terms of work/life balance, job satisfaction, benefits, and more. But that’s left employers scrambling to fill multiple vacancies and shone an exceptionally bright spotlight on the need to have a strategy in place for recruitment, retention and talent management. The Great Resignation is affecting businesses of all sizes across all industries – and the banking industry is certainly no exception.

While some of you may be feeling uneasy about the state of your own workforce, I submit that this is actually a time of great opportunity – because while a lot of people are leaving their jobs, it’s a signal that many talented employees are also looking for jobs and are open to career changes.

That’s an opportunity that our industry can’t afford to miss.

To help more talented and diverse individuals find their future in banking, ABA is partnering with more than 30 state bankers’ associations and pooling our resources to enhance BankTalentHQ (banktalenthq.com) – the nation’s single best source for banking jobs. Bankers can use BankTalentHQ to post new job openings, and job seekers will use the platform to find great opportunities in banking. ABA will be busy sharing the real stories of dedicated employees in banking today.

One of the things that make our industry so attractive to prospective hires is the incredible range of opportunities that can come with a career in banking. Banks need marketers,



IT experts, programmers, data wizards, cyber pros, compliance experts, and human resources gurus – not to mention all the important positions people have long associated with banking, like loan officers or tellers. BankTalentHQ will help connect more qualified people with our industry and the exciting career path that awaits them in banking.

The Great Resignation has also prompted many banks to reconsider their benefits offerings. If you're looking for a way to bring young talent in the door to stay, one strategy I highly recommend is to offer some form of student loan repayment assistance. It's something we've tried at ABA with great success, and in my view, it's one of the ways banks can distinguish themselves as some of the best employers in the job market.

If your bank isn't offering a student loan repayment option, I encourage you to explore the possibility with your HR director. These programs can be tailored in virtually any way to support your organization's talent acquisition and retention strategy.

The reality is that many young people today are graduating college with the equivalent of a small mortgage worth of student debt. That is a tremendous burden, and stepping up to help your workers tackle this debt can set your bank apart both in recruitment and retention.

Beyond offering perks, talented professionals also need ample opportunities to advance within the organization, hone

One of the things that make our industry so attractive to prospective hires is the incredible range of opportunities that can come with a career in banking.

their skills or explore new areas of interest. ABA offers a wide range of online training, continuous learning and certification programs for bankers at all levels of their careers. (You can check out all of these offerings at www.aba.com/DevelopTalent.) We also support up-and coming-bank talent through our Emerging Leaders Open Committee and our new Emerging Leader Awards, which recognize the next generation of high achieving bank leaders.

Cultivating the next generation of bank talent is essential to ensuring the continued viability and vitality of our industry. At ABA, we are committed to bringing you the tools and resources you need to navigate the Great Resignation – and come out on top in the search for talent. ▀

Email Rob at nichols@aba.com.

6 Low-Cost Ways to Improve Your Cybersecurity



Your business is exposed to a variety of risks every day. Improving your cybersecurity can feel like a daunting task, but there are a few ways you can get started quickly. If you are unsure where to start, our security experts offer six low-cost, easy solutions that you and your team can implement to boost your security right now.

1. Data Backup and Recovery

Backing up your data is crucial but not all backups are the same. It is critical that you have an offsite data backup solution, keeping your data protected and stored outside your network.

2. Endpoint Detection Response (EDR)

Traditional antivirus software is not sufficient protection for your financial institution. Antivirus requires regular database updates of the current virus signatures to be effective. The protection afforded by AV software is only as good as the vendor's updates. Often, threats are discovered only after the damage is done. EDR uses artificial intelligence to detect threats without having to rely on virus signatures.

3. Multi-Factor Authentication (MFA)

Two of the best methods for establishing extra lines of defense for your online accounts are using strong passwords and setting up 2-factor or multi-factor authentication (also known as 2FA or MFA). Using different passwords for each of your accounts is another best practice to hinder an attacker and keep your data, accounts and network safe.

4. Third Party Patching

Keeping your devices, browsers and other tech up to date is one of the best, first lines of defense against cyberattacks. Security patches and updates fix any technical bugs and essentially "lock" your software and devices before bad actors can make a copy of the "key."

5. Avoid Suspicious Emails

With phishing, hackers attempt to gain access to your information or credentials through your email inbox. Phishing scams may seem like a relic of the past but have become one of the main culprits behind countless cyberattacks. Here are a few quick tips.

If the email address, link or contents look suspicious:

- Do not engage with the message or sender.
- Do not open the email, click on links or provide information.
- Contact your IT support immediately.

6. Book a Free Consultation

Hamilton is here to help mitigate and eliminate cybersecurity threats to your financial institution. We offer services from training, to network penetration tests and vulnerability assessments. **Contact us today to book a free consultation and learn how our cybersecurity solutions can help minimize vulnerabilities and protect your business data.**



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Advice for the Corporate Trustee

Krista Eckhoff & Brian Barmettler, Baird Holm LLP

CORPORATE TRUSTEES HAVE TO CONFIDENTLY KNOW THE answers to many questions, both those uniform to all trusts, and those tailored to the specific assets of a particular trust vehicle: who is a beneficiary? What obligations are owed to those beneficiaries? How can I deal with complicated family dynamics? What can I do if a family business has been operating in a way that would now be inappropriate when thinking about all beneficiaries?

For those banks or entities with trust powers who serve as corporate trustees, the fiduciary role by default raises those important questions, and requires that you have answers readily available. Your obligations and duties as a corporate trustee require you to inherently understand the relevant trust document itself, as well as Nebraska law as reflected in court decisions and the Nebraska Uniform Trust Code. This article will explore some of those nuances, and provide a framework to address the challenges facing corporate trustees.

General Duties

A corporate trustee's duties have been defined by the Nebraska Supreme Court:

A trustee has the duty to administer the trust in good faith, in accordance with its terms and purposes and the interests of the beneficiaries, and in accordance with the Nebraska Uniform Trust Code. The Nebraska Uniform Trust Code states that trustees owe the beneficiaries of a trust duties that include loyalty, impartiality, prudent administration, protection of trust property, proper recordkeeping, and informing and reporting.

In re Conservatorship of Abbott, 295 Neb. 510, 526, 890 N.W.2d 469, 482 (2017). Thus, proper trust administration must always begin with a thorough understanding of the terms of the particular trust document. Those terms provide the necessary guidance and should reflect the testator's

intent, which the corporate trustee must implement in its administration of the trust.

Understand the Mandatory Obligations

Reflecting its central role in trust administration, the trust document itself may modify the otherwise ordinary obligations of the corporate trustee, subject to the mandatory provisions imposed by the Nebraska Uniform Trust Code. Those mandatory terms cannot be varied by the settlor in the trust. They include:

- The duty to act in good faith and in accordance with the terms and purposes of the trust and interests of the beneficiaries (subject to NEB. REV. STAT. §§ 30-4309, 30-4311, 30-4312);
- The requirement that a trust and its terms be for the benefit of its beneficiaries;
- The duty to keep the qualified beneficiaries of the trust reasonably informed about the administration of the trust and of the material facts necessary for them to protect their interests;
- A trust instrument cannot relieve a trustee of liability for a breach of trust committed in bad faith or with reckless indifference or if such a term of a trust instrument was inserted as a result of an abuse of a fiduciary or confidential relationship between the trustee and settlor.

NEB. REV. STAT. §§ 30-3805, 30-3897. Consequently, in addition to having a detailed understanding of the trust document, the corporate trustee's actions must be guided by the mandatory provisions of Nebraska trust law that are applicable to all trusts, and to all trustees.

Determine the Beneficiaries and the Duties Owed to Each

While determining beneficiaries presents an ordinary and simple task in most instances, certain types of beneficiaries raise special concerns, as illustrated by the analysis regarding contingent beneficiaries. The question of duties owed to a contingent beneficiary was addressed last year by the Supreme Court of Nebraska in *In re William R. Zutavern Revocable Trust*, 309 Neb. 542 (2021) (“*Zutavern*”). In *Zutavern*, the Trust at issue limited the distribution of the Trust property (shares in a company) “to those of my children and/or grandchildren who are [at the time of the surviving spouse's death] actively involved in the operation and management of [the company running the family ranching operation].” *Id.* at 546. One of the settlor's children and one of the settlor's grandchildren, who had been fired from the ranching operation, filed suit. *Id.* at 547. The surviving spouse, and current trustee, moved to dismiss and argued that, because the two individuals were no longer “actively involved in the operation and management” of the family ranch, they were

Many complicated issues arise in a trust administration, for which third party experts (accountants, attorneys, etc.) can provide advice. Of course, the next step after receiving such advice is to follow that advice when appropriate.

no longer beneficiaries and, therefore, did not have standing to sue the trustee. *Id.* at 549-50. The trial court granted the motion to dismiss, finding that the son and grandson were not beneficiaries and, as a result, were owed no duties by the trustee; the Nebraska Supreme Court reversed. *Id.* at 544.

The Court explained that a beneficiary need only be definite – meaning that such “beneficiary can be ascertained now or in the future, subject to any applicable rule against perpetuities.” *Id.* at 554 (citing NEB. REV. STAT. § 30-3828(b)). That the plaintiff son and grandson were not currently working on the ranch was irrelevant, as the timing of the determination focused on the future, upon the surviving spouse's death. Because the son and grandson were in the class of beneficiaries generally described in the Trust (“those of my children and/or grandchildren ...”) subject to the later determination (being “actively involved in the operation and management” of the ranch), they had standing to sue to enforce the trustee's fiduciary duties. *Id.* at 555-56. They had a contingent future beneficial interest in the Trust, and that alone was sufficient to prosecute their claims in court. *Id.*

The decision correlates directly with the Nebraska Uniform Trust Code's definitional section. The Code defines a “beneficiary” as a person who either (a) has a present or future beneficial interest in a trust, vested or contingent; or (b) in a capacity other than that of trustee, holds a power of appointment over trust property. NEB. REV. STAT. § 30-3803(3). The *Zutavern* case makes it clear that a definite beneficiary (or



Counselor's Corner — continued from page 17

member of a definite class of beneficiaries) with a contingent future beneficial interest, even if the contingency is not presently met or even likely to be met in the future, is owed fiduciary duties.

Thus, any trustee should be careful when reviewing a Trust, and determine who the beneficiaries are, under the Trust itself and Nebraska law. Generally, fiduciary duties are owed to all beneficiaries, with some limited exceptions. To this end, only if a trust is revocable by the settlor can the trustee follow the settlor's directions that are "contrary to the terms of the trust." NEB. REV. STAT. § 30-3855(a). And, indeed, "[w]hile a trust is revocable, rights of the beneficiaries are subject to the control of, and the duties of the trustee are owed exclusively to, the settlor." NEB. REV. STAT. § 30-3855(b). Understanding the nature of the trust, the beneficiaries, and the duties owed to those beneficiaries will set up a trustee for success.

Change Existing Business Operations if Needed

Upon assuming his or her role, a trustee may realize that the persons associated with the trust property have become accustomed to operating in a particular way, irrespective of the terms of the governing trust document. As uncomfortable as it may be for the beneficiaries or others who operated the business, a trustee could be in breach of their fiduciary duties if they fail to change the operations to ensure the interests of all beneficiaries are considered. This exact issue arose recently in *In re Estate of Forgey*, wherein the Nebraska Supreme Court assessed a penalty against a trustee who

failed to collect rent, 298 Neb. 865, 906 N.W.2d 618 (2018). In that case, there was a family-operated cattle operation in which the profits were shared, but no rent was paid by the participants. *Id.* at 888. After the grantor passed away, the trustee (one of the individuals operating the cattle business) continued in the cattle business without collecting rent. *Id.* The Nebraska Supreme Court found that the continued commitment to the status quo was a breach of fiduciary duty. *Id.* at 889. The Court assessed a penalty against the trustee of the amount of rent he failed to collect against the remaining operators of the cattle operation (the trustee himself and another beneficiary). *Id.* at 890.

Therefore, a trustee must be cautious about following the prior business operations or patterns, if not consistent with the trust documents or the best interests of the beneficiaries. The beneficiaries may push or try to pressure a trustee to follow those business practices, but the trustee should be guided by the trust document and Nebraska law.

Use Experts When Needed

Equally important to the trustee's sound administration is the consultation of experts. To illustrate, in the *Forgey* case discussed above, the Nebraska Supreme Court also penalized the trustee for losses associated with the failure to file the trust's federal estate tax return, which resulted in penalties and interest of approximately \$2,200,000. *In re Est. of Forgey*, 298 Neb. 865, 872-73, 906 N.W.2d 618, 626-27 (2018). The trustee had hired a CPA who prepared the tax return, but then nevertheless failed to sign and mail it on time. *Id.* at 872.

Although a trustee's hiring of experts was not specifically addressed in the court's opinion, this serves as a lesson to employ necessary experts to assist with trust administration – and then follow their advice and instructions. Many complicated issues arise in a trust administration, for which third party experts (accountants, attorneys, etc.) can provide advice. Of course, the next step after receiving such advice is to follow that advice when appropriate.

Leave Your Emotions at the Door

Above all, when there are two or more beneficiaries, the trustee must act impartial between them. *In re Est. of Stuchlik*, 289 Neb. 673, 688 – 90, 857 N.W.2d 57, 69 – 71 (2014), *opinion modified on denial of reh'g*, 290 Neb. 392, 861 N.W.2d 682 (2015). This includes impartiality in investing, managing, and distributing trust property, while also giving due regard to the beneficiaries' respective interests. *Id.* at 70. This impartiality is not just an objective standard of equality, but must be determined from the settlor's intent, as reflected in the terms, purposes, and circumstances of the trust. *Id.* at 70. Nebraska courts, which have cited to the comments to the Restatement (Third) of Trusts, have explained that this, unfortunately, can be complicated by the difficulty of determining the relevant aspects of the settlor's intent. *Id.* In general, impartiality means that a trustee's treatment or conduct in administering

a trust should not be “influenced by the trustee's personal favoritism or animosity toward individual beneficiaries.” *Id.*

While a corporate trustee may feel immune from the difficulties that a family member trustee might experience regarding impartiality, a corporate trustee (or, at least a trust officer or advisor) is human. If one beneficiary is more difficult or abrasive than another, even the most professional trustee could find themselves feeling animosity toward that beneficiary. The best course is to go back to the trust document and remain as impartial as possible – documenting decisions as necessary. And difficulties are not unheard of with trusts, especially family disputes. *See, e.g., In re William R. Zutavern Revocable Trust*, 309 Neb. 542 (2021).

Therefore, here are some tips for corporate trustees:

- Review the Trust Code every so often;
- Keep updated on recent legal developments;
- Review each trust document for the trusts you are handling, and familiarize yourself with the trust terms, trust property, the beneficiaries, and family dynamics;
- Document your conversations with beneficiaries, when possible and as necessary;
- Utilize experts as needed, including tax experts, legal counsel, or others. ▶

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Changes to Watch For in 2022

Christy Thomas, CPA, CISA, CDPSE, Senior IT Auditor/Regional Director,
SBS CyberSecurity



CYBERATTACKS NO LONGER JUST IMPACT THE TARGETED organization but often have a ripple effect that harms partners, service providers, customers, and others. As data breaches trend up, organizations will be forced to spend more money to recover and ensure they have the appropriate solutions in place to prevent attacks without disrupting normal business. The role of the information security officer (ISO) is more important than ever when it comes to ensuring organizations are taking every precaution to avoid becoming victims.

The following topics should be considered by all financial institutions as part of reviewing the Information Security Program and implemented as deemed necessary.

Bank Protection Act of 1968

With the transition to remote audits and exams, an emphasis on the Bank Protection Act of 1968 has been incorporated into IT audits to ensure the organization is adequately managing and monitoring physical security in alignment with regulation and risk. Physical in-person security checks can be a struggle with the trend of remote audits by external auditors and examiners. Typically, videos or photos are used to examine physical security as part of the audit. As an additional step, a security officer should be officially named to ensure all requirements of a thorough physical security program are implemented, including an annual report to the board of directors.

FFIEC Updated Guidance

The FFIEC released updated guidance in August 2021 regarding authentication and access measures, which included bullet points of emphasis on customer awareness and education programs. Institutions should be making improvements and adjustments accordingly. An emphasis on specific policies will be incorporated into audits as well. A customer awareness program should include any cash management customers, specifically ACH originators and merchant remote deposit customers, and the ability to ensure they are aware of security protocols and abide by the expectations set forth in the respective agreements.

New/Updated Policies

The following policies should be documented within an Information Security Program, and some have become formal recommendations by examiners and regulators within the last 12 months.

- **Imaging Policy:** Address the storage of critical documents to ensure readability and accuracy, responsibility, procedure, and disposal of original documents.
- **ATM/Debit Card Management Policy:** Include policy and procedures to address the following: application process, employees authorized to order/issue cards, card activation procedures, PIN change procedures, receipt of returned PIN mailers, receipt

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of returned debit cards, logging documentation, contacting the customer for pick up/address changes, length of time to hold cards prior to being logged and destroyed.

- **Instant Issue Policy:** Describe the instant issue environment, authorized access, security controls (both physical and logical), dual control, inventory, monitoring, internal audits, and related procedures.
- **Internet Banking Policy:** Designate responsibility of the program, summarize all Internet banking services, describe the risk assessment process, define transaction processes, determine appropriate training, and ensure all aspects of the Internet banking program are adequately addressed. Also, reference FFIEC Authentication and Access to Financial Institution Services and Systems (Aug. 2021) as appropriate.
- **Multi-Factor Authentication:** Enhancing network security with MFA solutions helps increase data-center security, boosts cloud security for a safer remote working environment, and minimizes cybersecurity threats. Additional controls surrounding administrative access to directory services, network backup environments, network infrastructure, organization's endpoints/servers, remote access (employees and vendors), and firewall management are recommended.

Many cybersecurity insurance vendors are now requiring organizations to complete a self-attestation to renew policies. Included within the attestation is the verification of multi-factor authentication for remote access users and administrative users.

Contract Review Procedures

The vendor management program continues to evolve and requires diligent monitoring and research, especially for those vendors deemed critical to operations. Furthermore, the FFIEC has outlined contract review guidelines within the Information Security Booklet which should be used as a guide in evaluating new contracts and renewals for risk.

Formal contract review procedures should be developed and include, but not be limited to, the following: scope of

service, performance standards, security and confidentiality, controls, audit requirements, reports available for review, business resumption or contingency plans, subcontracting, ownership and license of data, dispute resolution, termination, assignment, regulatory compliance, and breach notification procedures.

Microsoft365 Controls Assessment

To mitigate multiple cyber threats, an independent assessment of the Microsoft365 environment should be performed after implementation and occasionally thereafter. The independent assessment should evaluate the environment and ensure the organization has implemented appropriate controls to mitigate risks including malware, third-party app access, data loss prevention, external sharing, advanced threat protection, and permissions.

Backup Best Practices

It is critical to maintain offline, encrypted data backups and to regularly test your backups. Backup procedures should be conducted on a regular basis. It is important to implement a range of disaster recovery measures to prevent and mitigate ransomware attacks, including keeping multiple backups on and off site, replicating critical data, encrypting data, and air-gapped backup.

An additional step is immutable backups. An immutable backup is a backup file that cannot be altered in any way. It should be unchangeable and able to deploy to production servers immediately in case of ransomware attacks or other data loss. By keeping an archive of immutable backups, you can guarantee recovery from a ransomware attack by finding and recovering the last clean backup you have on record.

If a third party or managed service provider is responsible for maintaining and securing your organization's backups, ensure they are following the applicable best practices. Using contract language to formalize your security requirements is also a best practice. ▀

For more information, contact Robb Nielsen at 605-251-7375 or robb.nielsen@sbscyber.com. SBS helps business leaders identify and understand cybersecurity risks to make more informed and proactive business decisions. Learn more at www.sbscyber.com.





2022 Key MBS Themes and the Case for Specified Pools

Andrea F. Pringle, The Baker Group

THE MORTGAGE MARKET IS ALREADY off to a volatile start in 2022, with Treasury yields soaring, spreads widening, and mortgage rates breaching 4%. The Federal Reserve has made clear it will focus on a robust monetary tightening campaign to combat high inflation by ending mortgage-backed securities (MBS) purchases and likely shifting the reinvestment of mortgage paydowns from MBS to Treasuries. This comes on the heels of record home price appreciation (HPA) and expectations for prices to continue rising at a modest pace, increasing loan sizes. These factors create headwinds for MBS performance in 2022, especially for pools comprised of generic or “to-be-announced” (TBA) collateral. Pools containing “specified collateral” (described below), on the other hand, stand to outperform TBA as the Fed taper and rising loan sizes impact TBAs more directly.

Higher Supply

A record net supply of agency MBS was set in 2021 and the Fed purchased about two-thirds of it. Although net supply is not forecasted to be as high in 2022, without the biggest buyer in the market, available supply would increase even if net issuance remained level. However, 2022 supply could be boosted by continued HPA. Supply is strongly correlated with HPA and home values are projected to moderately increase in 2022. Additionally, the Fed is expected to finish adding MBS to its portfolio in March and to cease reinvesting mortgage principal paydowns this

summer. All of this means the private market (ex-Fed) will have to digest significantly more supply in 2022.

It is also important to remember that the supply the Fed has been taking out of the market is TBA collateral. This is the “cheapest-to-deliver” (CTD) or “worst-to-deliver” (WTD) collateral that has been stripped of loans that offer added value to investors. Loans with certain characteristics that exhibit more predictable prepayment behavior are pulled out of TBA and pooled separately into “specified” pools. Because loans with these desirable attributes are carved out of the TBA float, what is left in TBA is the least desirable loans. Without the Fed sopping up that CTD/WTD float, supply pressure stands to impact TBAs more directly than specifieds.

Higher Loan Sizes

Higher loan sizes will also likely hit TBAs more directly. The Federal Housing Finance Agency raised the conforming loan limit by a record 18% for 2022, up to \$647,000. This means some loans previously considered “jumbo-conforming” are now eligible to be securitized into TBA. That could push the average loan balance of what becomes part of the TBA float higher and hurt valuations as pricing adjusts to account for the larger loan balances.

Larger loan balances are generally less desirable to investors because prepayment behavior is highly interest-rate sensitive. The larger the loan size,

MBS Themes — continued on page 24

the more economic benefit a borrower realizes by refinancing when rates are low and the more economic burden a borrower endures to refinance or move when rates are high. That means these loans have a tendency to perform the exact opposite way an investor hopes by prepaying fast when rates are low and extending when rates are high. By increasing the average loan size in the TBA market, the collateral skews a bit less desirable and pricing adjusts to reflect that.

Home price appreciation also organically pushes up the average loan size of new MBS. Analysts estimate home prices to appreciate around 5% to 7% in 2022 after increasing nearly 20% in 2021. Additionally, with higher rates, supply will increasingly be comprised of purchase loans and fewer refi loans. Purchase loans tend to have larger loan sizes, especially when home prices are on the rise. Further, the refi loans made in this environment will also shift from primarily “rate and term” refinances, which characterize low-rate environments, towards cash-out refinances. Cash-out refis tend to have larger loan sizes because borrowers take cash out of the equity in their homes by increasing the size of their mortgage.

Prepayments

What these dynamics mean for prepayments may seem straightforward on the surface in that higher rates and higher

loan sizes slow speeds as borrowers are less incentivized to refinance ... but by how much? With rate and term refis down, turnover and cash-out refis become an increasingly important part of the picture, and both are buoyed by strong HPA. However, record low housing inventory creates a challenge for turnover activity. Excess mortgage industry capacity following the hiring surge in 2020 and 2021 may also incentivize mortgage lenders to target previously untapped borrowers for refis in effort to keep business elevated.

All these dynamics create some uncertainty for the mortgage market. One certainty is that these factors will not impact the entire market the same way. Some sectors will feel certain headwinds more directly than others but that should not deter investment in MBS. Investors should simply be strategic about where to direct investment dollars and consider specified pools over TBA. ▶



Andrea F. Pringle is a Financial Strategist and MBS Analyst at The Baker Group. She began her career in Washington, DC, where she also earned her MBA from George Washington University. Andrea worked on the Capital Markets Sales and Trading Desk at Fannie Mae for five years before returning to Oklahoma to work in corporate finance. Andrea joined The Baker Group in 2020, and her work focuses on mortgage products. Contact her at 800-937-2257 or apringle@GoBaker.com.



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- **MBS/CMO Market** — Balancing prepayment and extension risk in an uncertain mortgage rate environment
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DATA PROTECTION

Questionable Incoming Wires and What to Do About Them

Compliance Alliance Staff

ONE TOPIC WE CONTINUE TO HEAR ABOUT IS THE PREVALENCE of questionable wires coming into customers' accounts at the bank. Whether it's part of the classic "Nigerian Prince" scam – where a fraudulent wire temporarily hits the customer's account in exchange for a smaller payout from the customer's own funds – or a con artist is wooing an unsuspecting elder from afar, these suspicious transactions seem to be showing up more and

more. A common question we receive is, "How can I stop these kinds of shady wires or put a freeze on them before they cause the customer (and by extension the bank) a whole lot of pain?" While the answer to that question is not straightforward, a solution may be simpler than one realizes.

Article 4-A of the UCC generally only requires domestic (not international) wires to be considered final once the receiving

bank accepts them; beyond that, there is not any prohibition we're aware of on a receiving bank freezing or sending back wired funds, even if they are not recalled by the sending bank first. Nevertheless, a receiving bank should be aware that there may be some risk with freezing and/or sending back wire funds without some sort of investigation into the circumstances beforehand.

First of all, for incoming domestic wires, there's Regulation CC – wired funds are generally required to be made available to checking account customers “not later than the business day after” the wire is received (not necessarily accepted under the UCC!) by the incoming bank. Granted, it's always possible to place an exception hold on the wired funds with proper notice to the customer, but the bank should make sure to do at least a rudimentary investigation before placing such a hold in order to substantiate that it is reasonable.

Secondly, beyond the outer time limits stated in Regulation CC, an institution's own funds availability policy may provide an even quicker turnaround time for incoming wired funds to be made available, such as the same day the funds are received. An institution would want to check its availability policy to ensure it contains nothing to legally obligate them to promptly provide wired funds.

Thirdly, even if neither Regulation CC nor the bank's funds availability policy comes into play (like for international wires), there are reputation risks and fairness issues to consider. Especially in service areas with a large international population, it may be seen as an unfair banking practice to, say, place a “writ large” freeze or hold on all incoming international wires no matter what.

Ultimately, though, beyond the Regulation CC, funds availability policy, and reputation risk/fairness issues noted above, we know of no restriction on a bank placing a hold/freeze or returning incoming wired funds before “accepting”



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them. In fact, in light of things like Office of Foreign Assets Control (OFAC) monitoring requirements under the Bank Secrecy Act (BSA), it may be desirable for an institution to hold or return an incoming wire it's not sure about, especially if that institution isn't used to receiving incoming wires as a regular part of their business. In the

end, it will come down to an overall risk determination in light of the bank's practices. But having checks in place on incoming wires – especially international wires coming in from other countries – is generally not prohibited and may even be recommended, as internet-related wire scams continue to increase in popularity. ▶



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