Colorado Banker

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# How to Attract and Retain Top Talent

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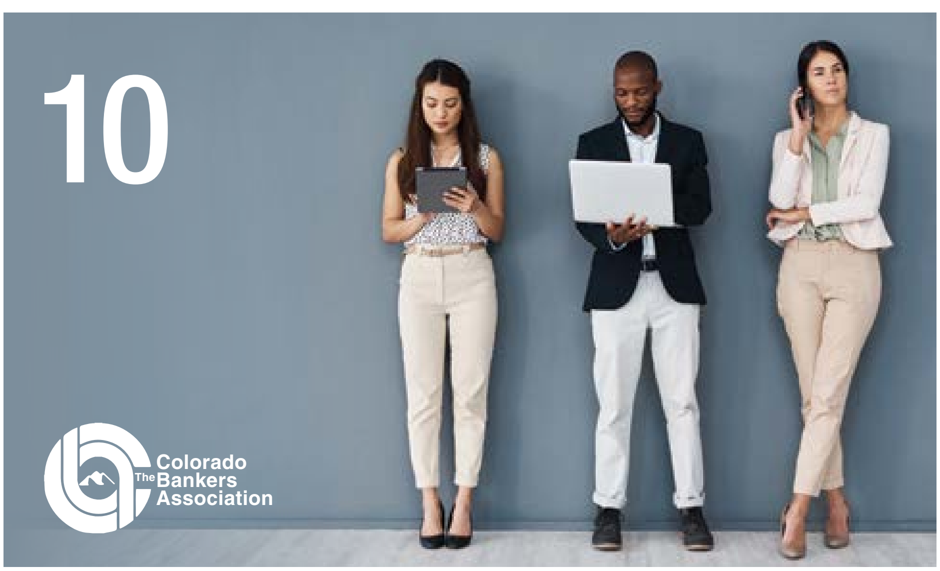


## Over a Century

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## A Word From CBA

By Mike Brown, Regional President
Alpine Bank 2021-2022 CBA Chairman

# Colorado Legislative Session

How quickly time passes! We are more than one-third of the way through the Colorado legislative session, and as of Feb. 25, 442 bills have been introduced. While this may seem like a lot, we have not seen nearly all the bills we are anticipating. And while the road ahead remains bumpy, rest assured the Colorado Bankers Association is diligently monitoring every word of every piece of legislation that may affect our industry, today and tomorrow. Here are just a few of the bills that we're watching closely:

Credit unions are seeking a change to allow them to accept deposits from government entities, including cities, counties and municipal districts. Credit unions also seek to expand operations beyond their common bond to provide loans to public entities. We have received a draft bill proposing these actions, and we anticipate its introduction in early March. The CBA team has been working to garner broad opposition to this bill. Thank you to those bankers who have been advocating against these flawed policies. I also thank the CBA staff for its diligence in attacking this attempt by the credit unions to expand an already inequitable business advantage.

On the affordable housing front, the Colorado Housing and Finance Authority (CHFA), under the Colorado Affordable Tax Credit program, is already allowed to allocate income tax credits in an annual aggregate amount of up to $10 million until Dec. 31, 2024. House Bill 22-1051 extends this period to Dec. 31, 2034, and increases to $15 million the annual aggregate cap for the years beginning Jan. 1, 2023, and ending Dec. 31, 2034. The CBA supports this legislation to promote additional affordable housing options.

Another bill, Senate Bill 22-86 (also referred to as the Homestead Act), expands the limits on homestead exemptions, changes the definition of a dwelling and removes the requirement for commingling of funds. CBA's staff is working closely with the proponents of this legislation, the bill sponsors, and a coalition of interested parties to amend the legislation to address commingling of exempted funds as well as adjustments to the exempted amounts.

Finally, the CBA is closely monitoring legislation to replenish the state unemployment fund. One bill has been introduced, and we anticipate the introduction of additional legislation to address this critical business issue.

Again, this is only a sample of the myriad legislation in the current session. If you have questions, do not hesitate to contact the CBA team.

# Cybersecurity in Times of Tension

By Anne Benigsen
CISSP, President
CivITas Bank Solutions

> Review and ensure that backups and compliance understand the new reporting requirements and keep up with any changes.

The crisis unfolding in Ukraine is creating a ripple effect in the United States that impacts our daily life. This article consolidates information on what is expected of financial institutions and suggests strategies for mitigating potential nation-state attacks.

Some financial institutions have already taken such actions in the course of business, and others began making changes as a preventive measure in today's cyber threat-ridden climate long before the invasion of Ukraine. The following recommendations are meant to be an addendum to your already strong cybersecurity posture.

CISA hosts a Shields Up page (cisa.gov/shields-up) which is a resource to help reduce cybersecurity risk.

Please include these contacts in your incident response policies and business continuity plan:

- CISA via the 24/7 CISA Central at central@cisa.dhs.gov or 888-282-0870.
- FBI at your local office or cywatch@fbi.gov and 855-292-3937.

Seriously consider performing a documented review/internal audit of the following in early 2022:

- Look into your cybersecurity insurance policy and ensure that it will cover nation-state attacks and a ransomware negotiator to whom you will have access.
- Review and ensure that backups and compliance understand the new reporting requirements and keep up with any changes. There is a bill currently going through Congress which will require critical infrastructure to report to the Department of Homeland Security within 72 hours with the ability to shorten that timeframe significantly. Additionally, CISA may shortly become the hub for cybersecurity concerns.
- Validate all remote access, administrative access, and privileged access controls.
- Verify multifactor authentication is present on all the above. If not, ensure access is accepted with compensating control lists. If MFA is not available on a device, consider having it set as an explicit exception.
- Confirm that the review/audit has been completed and all ports and protocols that are not essential are blocked. In addition, use this opportunity to go through the firewall and clean out any stale entries or old rules.
- Make sure any cloud services have been audited recently and have appropriate security. CISA has posted suggestions at cisa.gov/uscert/ncas/analysis-reports/ar21-013a. This is a growing priority in regulation and a heavy focus of threat actors. Knowing how to secure your cloud environment is not the same as securing on-premises or in a data center. Both the senior management of your bank and the regulators need

assurance that you recognize those differences. Make sure the risk assessments and control lists reflect that distinction.

- Verify that detective controls are in place. Because we cannot prevent every threat, the ability to recognize and stop them immediately is key. Document which tests and exercises have been done to determine the detective controls are functioning. Detective controls are only as good as what they can detect. If your controls have never been tested or found any threat, there is no proof that your systems work.
- Run an incident response team test/tabletop or live exercise to ensure that everyone knows their duties, that appropriate backups are available, and have the appropriate authority. Sometimes exercises can be as simple as taking a random sampling of your organization and asking, “What do you do if you think ransomware has been installed on your workstation?” Ensuring that all employees know what to do is as important as a well-prepared incident response team.
- Run a recovery test on all backups.
- Ensure social engineering testing is performed in your organization regularly.

- Execute vulnerability scans on a regular basis and perform focused penetration tests as needed.
- If you have internal development or utilize contracts, audit the development process and ensure that the code has current security tests and that any front-facing applications have been tested using OWASP Top 10 found here owasp.org/www-project-top-ten/.

These proactive steps will help senior management and the board understand the cybersecurity landscape of your business. Carrying out these actions reflects a level of maturity, especially during this time of tension as our regulators and the world at large are watching to see if we are taking the necessary steps to protect the people and businesses we serve — and our country itself.

# Banking Needs Apprenticeships

By Tom Hershberger
Cross Financial
Chairman and Founder

I enjoy listening to Mike Rowe. In addition to his captivating narrative voice, he has a personality that comes through in how he tells a story. From the star of Dirty Jobs to the voice for Deadliest Catch and his Returning the Favor series, his voice pulls you into what is happening. It's just fun to listen.

In 2008, Mike started the mikeroweWORKS Foundation (mikeroweworks.org), which focuses on filling skilled labor gaps. I love that concept. In the case of American trades, there are plenty of jobs and a limited number of skilled workers.

Since 2020 many industries have experienced challenging staffing gaps and talent deficiencies. Talented workers, in all professions, are extremely valuable resources. If you have an army of them working for you, the outcomes are limitless.

## Identify, Recruit, Train

The challenge is figuring out the most effective way to identify, recruit, train, and employ their talents. In vocational trades, such as electrical, plumbing, ironwork, and carpentry, an apprenticeship often provides the education required to become a professional. It's a wonderful model. To learn a skill, new workers spend time with a talented professional who has honed their skills through years of experience. That seasoned professional is then challenged to teach those experience-based skills to an incoming worker. On-the-job training in action.

Now, consider the banking industry for a second. How do incoming workers learn their trade? How do they learn about the business of banking? How do they learn to solve customer problems? How do they learn to manage their projects or time? How do they learn skills that improve their productivity and work product? In many cases, it is on-the-job training without the structure and purpose embedded in the apprenticeship model.

## Banking Apprenticeship

Perhaps it is time to take a tool out of the vocational education toolbox and apply it in banking. If banking wants to develop a highly-skilled labor force, why not commit to creating an effective apprenticeship program? The quick answer would be, “Because the experienced professionals don’t have time to do the training.” Why? Because they are busy doing their job every day. But, wait, isn’t that how an apprenticeship works? The skilled professional is doing work that the apprentice gets to observe. And, when appropriate, the apprentice actually does the work. Fully supervised and evaluated through the entire process. If the worker is responsible for installing a new electrical box, the mentor watches them complete the work and assesses their finished task.

Here’s our chance, bankers. What can we do to create apprenticeships for incoming workers? The number of areas the new professionals can pursue in banking is similar to virtually every other business. Maybe banking should have an apprenticeship program for technology, customer care, finance, human resource management, facilities management, marketing, retirement planning, operations, even community service. The list goes on.

## Bring It With You

As part of the mikeroweWORKS scholarship program, committed students sign a S.W.E.A.T Pledge. It stands for Skill and Work Ethic Aren’t Taboo. One of the statements in the pledge says, “I do not follow my passion. I bring it with me.” What a great statement. Young professionals

> Talented workers, in all professions, are extremely valuable resources. If you have an army of them working for you, the outcomes are limitless.

are entering the banking industry with passion in their backpacks. Help them focus that energy on professional skills they can learn in a hands-on, supervised environment with a highly skilled professional at your organization. Create performance expectations for the mentor that hold them accountable for the development of their apprentice. The end result will be an exceptional contributor to your organization.

*Tom Hershberger is the chairman and founder of Cross Financial (crossfinancial.com), Lincoln, Nebraska, which offers financial institutions sales and marketing development services. Tom is also on the faculty of the Graduate School of Banking at the University of Wisconsin, as well as the GSB Sales and Marketing School; see gsb.org for details.*

# Meeting Consumer Expectations in the "Digital Banking Era"

By Joe Woods, SVP
Director of Sales & Marketing
Dolphin Debit Access

The results of the 2021 American Consumer Satisfaction Index (ACSI), a respected national survey of over 15,000 consumers, confirmed what some financial institutions have feared: A shift in consumer expectations resulting from digital banking/efficiencies taking precedence over good ol' fashioned, friendly, face-to-face customer service. A trend accelerated by a global pandemic and more easily navigated by financial institutions with deeper pockets to invest in digital delivery. Which begs the question: how do banks, both large and small, keep pace with this trend?

It's not the service that has changed, but rather how "consumer satisfaction" is defined in the current financial services landscape. But, with change comes opportunity. So, it's time to adapt, adjust, and give consumers the gift of innovation in 2022. Capitalizing on this trend means modernized self-service approaches, digitizing your branch strategy, re-allocating manpower and capital, and leveraging relationships to position yourself to keep pace with the digital consumer.

## Going Phygital — Bridging the Physical and Digital Gap

Although the definition of consumer satisfaction may be changing, areas such as helpfulness of staff and speed of transaction in the branch are still key performance indicators used in the study. The rise of digital banking has heightened consumer demand for self-service leading to a simultaneous increase in the popularity of interactive ATMs, better known as ITMs. This adoption creates an opportunity for banks, particularly those with a culture rooted in strong customer service, to capitalize on those strengths while modernizing their service approach. How? ITMs significantly increase the number of transaction types a consumer can perform at the kiosk and provides them with the option of on-demand video chat with a banking expert. The flexibility of ITMs bridges the gap between strong customer service and the self-service convenience consumers crave through an efficient, personalized solution that maintains the human element.

## Digital Branch Transformation

With branch visits remaining low either due to consumer choice or local market laws as the pandemic continues, banks are transforming into 24/7 capable self-service zones by adopting the necessary software and hardware required to achieve digital branch transformation or "smart branches." They use a design that flips the traditional branch model ratio with the majority of floor space dedicated to 24/7 automated service machines. Leading the charge for branch transformation are core-connected ITMs capable of advanced transactions that allow consumers to access all of their accounts, open a new account, cash checks to the penny, pay on a loan, issue bank check or money orders, etc., all with the option of assistance from a remote teller. This smart branch approach provides account holders with convenience and efficiency while allowing banks to extend branch hours and shrink their cost per transaction by reducing staff and overhead costs.

## Leveraging Vendor Relations to Improve Member Touchpoints

The consumer experience is, and long has been, a top priority for any bank. But, managing the many moving parts of a now FinTech driven industry requires time and manpower. The result is tedious, expensive, non-core competencies simultaneously cutting into precious capital and diverting staff hours away from important consumer-facing time. This is where the power of a strong strategic partnership can be a differentiator for banks.

Let's take your ATM-ITM network as an example. These interfaces are critical, high-volume touchpoints with account holders and, as discussed, a key element in keeping pace with digital consumer expectations. But management of an ATM-ITM fleet is an expensive operational nightmare for any institution that must allocate staff to keep up with hardware repairs, cash management, first & second line maintenance, Reg-E claims, software updates, security patches, and a multitude of other tasks.

Outsourcing the management of your fleet to a trusted vendor partner yields benefits to both the account holder and the institution by relieving staff of ATM management burdens while eliminating capital investment, cutting operational costs, and bolstering your self-service strategy to provide a positive interaction between account holder and institution, even after hours.

> The rise of digital banking has heightened consumer demand for self-service leading to a simultaneous increase in the popularity of interactive ATMs, better known as ITMs.

## Embracing Change

Adjusting to the expectations of the "digital consumer" comes down to institutional flexibility and goal-driven objectives that streamline operations and give consumers the convenience, efficiency, and "satisfaction" they demand from their bank. All it takes is a fresh perspective, a re-imagined service strategy, and the right people and partnerships to help you deliver.

# How to Attract and Retain Top Talent

By Erica Brune
President
Lever1

When unemployment stood at 14.8% in April 2020, nobody imagined hiring would be HR's greatest challenge just 20 months later. The sudden shift has employers seeking new ways to attract candidates and retain employees. Whether you are struggling to find top talent or enduring the Turnover Tsunami — we are all seeing the lingering effects of the pandemic through the tight labor market.

## Rethinking Recruitment

Prior to the labor shortage, if you had an open position, all you needed was a brief job description and a platform to post it on. Now, employers post their job ads on every recruiting platform and still struggle to find qualified candidates. The pandemic changed recruitment and the days of posting an ad online and hoping for the best are over. Employers are being forced to look at recruitment through a new lens in order to be successful.

All of this being said, it is still important to continue posting job ads online and on recruiting platforms, but the strategy behind the posting needs to change. The job posting should expand on the culture of your workplace and highlight why people look forward to coming to work every day. Obviously, it is important to continue to share job responsibilities and outline expectations, but candidates are looking for what sets your Project Manager position apart from 50 other companies' Project Manager positions.

In looking at your job ad, pay attention to the language you are using and what it would convey to someone who knows absolutely nothing about your company. A job ad is the first impression your company gets to make on future employees. By taking the extra step to ensure accuracy and formatting is correct, you will have more success with your job posting.

## Where to Look?

Due to the labor shortage, you can expect job boards and recruiting platforms to be bursting with job postings, so the likelihood of finding quality candidates is slim unless your opening checks all of the candidates' boxes. Studies show the three biggest recruiting challenges for employers are:

1. Finding candidates with the right skills
2. Hiring quickly enough to land the best talent
3. Finding candidates who complement the company culture

One route employers should consider when searching for top talent is hiring a recruiter. Recruiters have access to large networks of individuals with a vast array of skills and industries. The inherent ability to create relationships with almost anyone makes hiring a recruiter a seamless process. However, the effectiveness of a recruiter depends on your response time. A recent study showed that 39% of job candidates say 7 to 14 days is too long to wait for an employer's response. While navigating the tight labor market, you should be prepared to move quickly because most candidates will receive several job offers after only a single interview.

If the recruitment efforts take longer than expected, turn to your internal workforce. Companies are learning to do more with less and adapting their processes to accommodate a smaller staff and strained resources. While it is not ideal to ask your staff to buckle down and bear with you through this time, transparency will be important. Continue to keep your staff informed of your efforts and encourage them to make referrals or share the job postings to their networks. The increased communication will inspire loyalty and, in turn, increase retention.

## Get Creative!

In response to the ultra-competitive talent market, we are seeing 57% of employers offering referral bonuses and 43% boosting pay. Apart from raising wages, companies are looking at alternative benefits to attract and retain employees. One of the most requested benefits is flexibility, but employers are taking a different approach in some industries where flexibility is not possible due to the nature of the job.

Forty-four percent of employers are taking the opportunity to upskill and reskill their staff members through different training programs. Organizations are becoming increasingly aware of the impact coaching can have on the employee and the business. By implementing a training program, you can show your investment in your workforce

and care about their future with your company. The training opportunity can lead to increased morale and loyalty amongst the workforce.

Another differentiator when navigating the labor shortage is granting employees early access to their paychecks. Studies show that 83% of workers are eager to be paid at the completion of each working day. An accelerated payroll program allows employees to quickly gain access to their funds and encourages employer loyalty.

It may be easier to offer "fun" perks of happy hours and catered lunches; those tend to only be short-term culture changes. By providing long-term programs in your business, you show your employees and future employees that you care about their well-being and success with your organization. Whether through financial means or career development, candidates are looking for what your company can offer them beyond the typical benefits.

Washington Update

# Cryptocurrencies:
## Unlocking Banking's "New Frontier"

By Rob Nichols, President and CEO
American Bankers Association

In case you haven't noticed, cryptocurrencies are an increasingly hot topic of conversation in this country.

According to a Pew Research Center survey fielded in November, 86% of Americans said they have heard about cryptocurrencies, and 16% said they have invested in, traded or used them. Cryptocurrency use is growing particularly rapidly among younger Americans, with 31% between 18 and 29 telling Pew they have participated in crypto transactions.

More often than not, these trades are happening through financial intermediaries — and consumers are increasingly turning to banks to hold these digital assets. In fact, I've heard from a growing number of bank leaders that their customers want to buy, hold and use crypto — and they want to do it through their banks.

Banks have already begun making inroads into the crypto services business — offering a responsible pathway for consumers to adopt these novel financial products. For example, a community institution based in Oklahoma, recently launched a crypto custody account that bank customers can manage in their app alongside their FDIC-insured dollar account. Or another bank, which offers a checking product that provides rewards in bitcoin, offering consumers an opportunity to wade into the crypto space without buying it themselves. Large custody banks are also developing custody services for crypto.

Bank customers know they can rely on their banks to steward their finances and keep their financial data safe. A recent Morning Consult poll highlighted that banks are the most trusted among all financial services providers. Given that, it's no surprise that consumers want to receive cryptocurrency services from their bank. But don't just take my word for it: a survey from NYDIG, a bitcoin services firm, confirmed that a whopping 81% of bitcoin holders would shift their bitcoin to a bank if it offered secure bitcoin storage. Undoubtedly, this "new frontier" of cryptocurrency represents a huge opportunity for banks.

But for banks to successfully navigate this new frontier, the bank regulatory architecture needs to catch up — quickly. More clarity is needed from the banking agencies about how banks can offer these services in a safe and sound manner. Without this clarity, the unlevel playing field between banks and the rapidly growing cadre of firms seeking to operate as banks while evading the full scope of bank regulations will continue.

There have been some positive developments, with the OCC issuing an interpretive letter clarifying its approach for approving crypto-related activities for national banks.

Additionally, a report by the President's Working Group on Financial Markets highlighted the risks of stablecoins, recommending they be issued by insured depository institutions subject to consolidated supervision. Any providers of custodial wallets should also be subject to appropriate federal oversight.

For our part, ABA is taking a deep dive into what we can do to support banks' participation in crypto and other digital assets through both our advocacy and technology partnerships. Additionally, in December, we invested in NYDIG, a leading provider of bitcoin services for banks. This investment will support banks' ability to meet customer demand in this rapidly evolving market so that as we unlock this "new frontier" of cryptocurrencies and digital assets, consumers can continue to place their trust in America's banks to meet their financial needs.

We understand that expanding into cryptocurrency products and solutions won't be for every bank, and that's okay. We firmly stand with banks in their right to decide what products they will offer according to their own judgment and market strategy. However, even with mixed opinions on the value of cryptocurrency as an asset class or as a basis for a product set, ABA strongly believes banks should have access to the tools, partners and regulatory frameworks that allow them to meet their customers' needs.

> "Bank customers know they can rely on their banks to steward their finances and keep their financial data safe. A recent Morning Consult poll highlighted that banks are the most trusted among all financial services providers.

*For more information, email Rob at nichols@aba.com.*

# What's the Real Motivation Behind Sweeping Changes to Overdraft Services?

## Avoid confusion and criticism with full disclosure and reasonable fees

By John Cohron
JMFA Chief Executive Officer

Changing market conditions and renewed interest by regulators to address products and procedures perceived as harmful to consumers have recently fueled sweeping changes in some overdraft strategies. For undisclosed programs and those with fees that have steadily escalated over the years, such changes may be necessary as regulators attempt to rein in overdraft practices that run counter to their calls for transparency.

The news from some of the nation's largest banks making major modifications doesn't mean that overdraft services aren't beneficial to consumers. It just means that some program strategies are out of line with regulatory expectations and what consumers need. This fact was punctuated recently in comments by Acting Comptroller of the Currency, Michael J. Hsu, who said, "Limiting overdrafts may limit the financial capacity for those who need it most."

In fact, in a joint letter to the CFPB, industry trade organizations representing both banks and credit unions have requested the agency to study consumers' preferences regarding overdrafts, including a list of areas that should be investigated.

### Sweeping changes can stir up unexpected consequences

Community banks should absolutely be re-evaluating their overdraft approach to ensure they are doing right by the consumers they serve. However, making changes without the right direction and resources can create difficulties for account holders who trust their financial institution to "have their back" when they have liquidity needs.

For instance, eliminating overdraft fees may sound appealing, but what happens when a transaction exceeds a customers' balance? Is it covered or returned? If it is returned — for a mortgage, rent or utility payment — will the result be a disruption of service or penalty fee that exceeds the original overdraft fee?

If the customer doesn't know when a transaction will be paid or is surprised by merchant return fees or other charges, how is that providing good service? Or, when a returned item triggers the reduction of a customer's credit score, making it more difficult to get a loan or land a job, how is that building trust for the future?

What's more, reducing an overdraft fee from $35 to $10 may seem like a major concession, but will other fees need to be put in place to make up for lost revenue? Swapping one fee for another — or increasing balance requirements to access a service — isn't exactly the best way to garner goodwill since it can make having a checking account unaffordable for some consumers.

## Prevent confusion and controversy with reasonable fees and transparent procedures

A consumer-focused overdraft strategy should include a beneficial last-stop option to your other service offerings, i.e., accessing funds from another account, a credit card or line of credit, that can help customers when they need access to liquidity. If they have difficulty managing their checking account and do not have a savings account or access to a line of credit to cover an expense, a fully disclosed, reasonably priced overdraft privilege service provides a reliable safety net.

When your customers know the fee and their limit upfront — along with how to use the service responsibly — they will find value in having access to convenient financial peace of mind.

## Gain confidence with a thorough program evaluation

The best approach begins with open communication and transparency regarding how your overdraft privilege services work. A comprehensive, professional program review can identify important details that will benefit your customers and your bank, such as:

- Does your overdraft strategy follow a consumer-first approach?
- Is your fee structure appropriate for your market?
- Are your processes and procedures fully transparent?
- Are your customer communications effective and compliant?
- Are you offering financial education to all customers to limit excessive overdraft usage?
- Do you have other service options available that might be a better fit for some customers?
- Is there an effective staff training program in place to increase employee knowledge and confidence?
- Which key metrics should you be monitoring to ensure effective program results?

## Stay on the customer side of service delivery

No one can ignore what's currently happening with market changes. But limiting access to a responsible overdraft privilege service isn't the right solution if your operational philosophy is built on providing financial stability to your account holders. Despite the current narrative, there is a need for overdraft services. More importantly, there is a way to deliver the service to be fair, transparent and consumer-friendly.

*JMFA is one of the most trusted names in the industry. Whether it's recovering lost revenue, uncovering new savings with vendor contract negotiations, creating more value, serving account holders better or delivering a 100% compliant overdraft service — JMFA can help you deliver measurable results with proven solutions. To learn more, please visit JMFA.com or call (800) 809-2307.*

# Don't Predict, Prepare
## Scenarios to Consider for Fed Rate Hikes

By Drew Simmons, Oklahoma Regional Account Manager, FHLBank Topeka

We examined recent comments from the Federal Reserve and devised a few scenarios to help our members prepare for what's next.

### The Federal Reserve's Outlook

The profoundly hawkish shift in tone from the Federal Reserve first appeared in their December 2021 minutes. This was evident- from the following quotes:

"…it may become warranted to increase the federal funds rate sooner or at a faster pace than participants had earlier anticipated."

"…it could be appropriate to begin to reduce the size of the Federal Reserve's balance sheet relatively soon after beginning to raise the federal funds rate."

Shortly after the minutes were released the first week of 2022, Bloomberg's Fed Rate Hike Probability Index moved to a 78% chance for March with a potential three additional hikes by year-end (Exhibit 1). By February, the chances for a March hike reached 100%. Combined with rising bond yields and inflation concerns, there's no question that the Fed has embarked on the next tightening cycle.

While all signs seem to point to a fast and aggressive Fed tightening, members should avoid predicting the timing and scale of the next rate cycle. Instead, ensure that your strategy prepares for several interest rate scenarios. The following are a few scenarios for consideration:

### Scenario No. 1 – The Next Tightening Cycle

The Fed hikes rates multiple times in 2022 and begins to reduce the balance sheet. If this goes on without any material market disruption, the next rate cycle will be underway.

### What to expect:

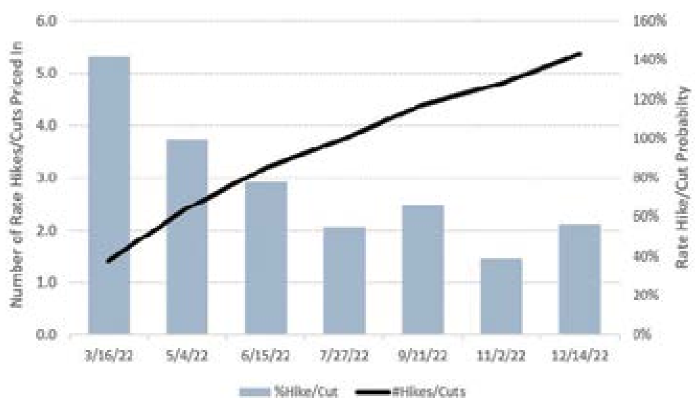
Institutions could see liquidity begin to decrease, loan demand increase, margins improve, and the economy move forward in a growth cycle.

### Scenario No. 2 – The Fed Tests the Market

The Fed's first rate hike following the Great Recession came in December 2015, and they didn't hike rates again until December 2016.

This "hike and wait" strategy was emblematic of one of the longest economic recoveries in modern history. The Fed could find themselves in a similar strategy should the COVID Omicron variant (or others) create economic challenges such as persistent labor supply constraints, disinflation and/or geo-political risks.

Exhibit 1 / Bloomberg's Fed Rate Hike Probability Index




What to expect: Institutions would experience high liquidity, low-to-moderate loan demand and tight margins as the recovery takes longer than expected.

### Scenario No. 3 – The Double-Dip Recession

We could enter a second recession that could be exacerbated by the Fed acting too soon and failing to identify unsustainable asset bubbles. This economic recovery doesn't fit the mold of prior recovery cycles, so we're in uncharted territory.

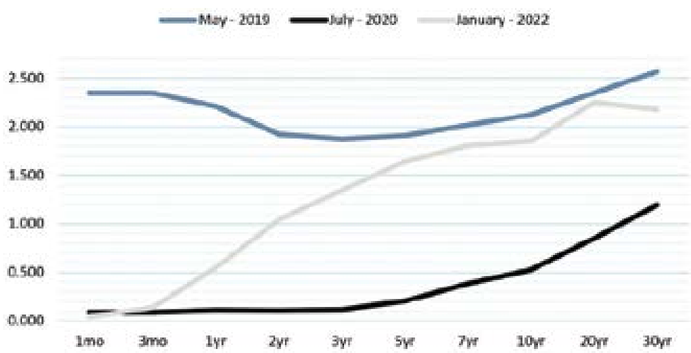
Stocks have done surprisingly well, reaching new highs each quarter since March 2020. There's been plenty of talk about an unsustainable housing market as well. Any major asset bubble could trigger another recession, which would force the Fed to crank back up its accommodative policy tools. There are also concerns of the recent flattening yield curve ahead of potential rate hikes.

## What to expect:

It's Groundhog Day with even more liquidity, low loan demand, further margin compression and interest rates moving back to record-lows.

"History doesn't repeat itself, but it often rhymes." This famous quote by Samuel Clemens (aka Mark Twain) is especially fitting today. The challenges brought on by the COVID-19 pandemic have been unprecedented, so answering the question of "what's next" is no easy task.

Exhibit 2 / Historic Yield Curves




However, recent history can at least provide a framework for strategy development. For example, we know that in every case where the United States Treasury yield curve has inverted, an economic recession was soon to follow.

Strangely enough, months before the very first case of COVID-19, the yield curve inverted in May 2019 (Exhibit 2). It's entirely plausible that even if the pandemic hadn't unfolded, a (less severe) economic downturn may have been inevitable.

Most financial institutions are asset sensitive and perform better in a rising rate environment. Generally, margins increase in rising rate environments, but that depends on the shape of the yield curve.

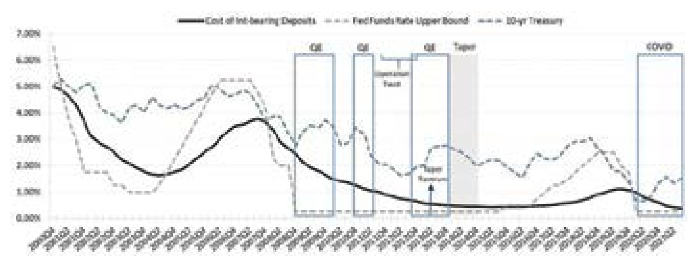
Bond yields have recently moved in a bear flattener position where interest rates have moved higher, but the difference between short- and long-term yields have compressed. In fact, 2022 began with an inverted yield curve as the 20-year treasury traded slightly higher than the 30-year long bond.

January's yield curve is also the flattest it's been ahead of a potential Fed tightening cycle (Exhibit 2). That's not exactly an ideal recipe for margin improvement.

> Most financial institutions are asset sensitive and perform better in a rising rate environment.

The chart in Exhibit 3 shows the changes in the upper bound target for the Fed Funds Rate and 10-year Treasury relative to the cost of interest-bearing deposits for members of FHLBank Topeka since 2000. The chart also highlights the Fed's Quantitative Easing and Tapering activity.

Exhibit 3 / Interest Bearing Deposits and Fed Funds Rate




One takeaway is that in both the rising rate periods that began in 2004 and 2015, respectively, deposit costs didn't reach their peak until the Fed had already reversed course and began lowering interest rates. If this trend persists as the Fed potentially increases rates this year, it could be 2023 before we see the next peak in member deposit rates.

A second takeaway is the 10-year Treasury yield reaches a terminal high ahead of the peak in Fed Funds. This pricing behavior can serve as a better forward-looking indicator in the market. Unlike the prior two rising rate periods, the 10-year is well ahead of the Fed.

There's a lot to unpack here with more questions than answers for members. But now, more than ever, thoughtful preparation for multiple rate path scenarios can go a long way to mitigate these uncertainties.

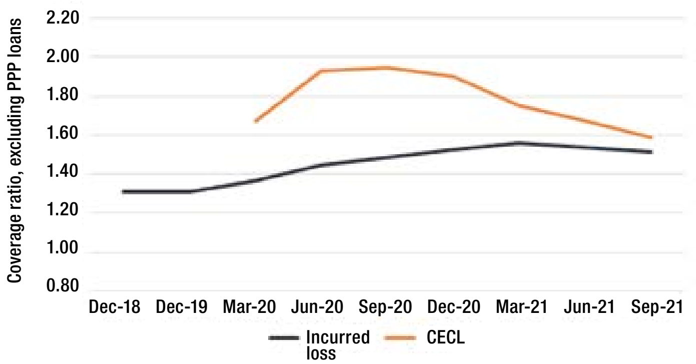
As always, the FHLBank Topeka team is here to help our members achieve their performance objectives and will continue to be a resource as we move forward in 2022.

*Drew Simmons is the Oklahoma Regional Account Manager for FHLBank Topeka. He has more than 20 years of experience in the industry. Drew studied finance at Oklahoma City University. He can be reached at 800.933.2988 or at drew.simmons@fhlbtopeka.com.*

# CECL: Where we've been and where we're going

By Ryan Abdoo, Partner
Kate Krones, Senior Manager
Plante Moran

As we reflect on the experience of the first 350 institutions to adopt the current expected credit losses (CECL) standard and prepare for the remaining 10,000 institutions to adopt over the coming years, it appears CECL may be achieving the results for which it was designed. While it's difficult to distinguish the impact of CECL adoption from that of the pandemic, it appears the standard has allowed institutions to be more responsive to ongoing uncertainty than was common under the incurred loss method.




As we've worked with institutions that have adopted the standard and others that are working toward adoption, we've identified two areas on which your institution should consider focusing.

## Understanding your model

We've seen institutions design models to estimate credit losses where the resulting reserve conceptually didn't make sense, even though the individual decisions made in developing the model were well supported. This could result from not understanding how the model works or certain assumptions having unexpected impacts. To combat this, we suggest taking a moment to assess your model and results from a high level and qualitatively evaluate what you're seeing. Do you have minimal loss history and yet, with almost no adjustments to that history, are projecting a large reserve? Are you expecting an improvement in the economic environment over the next year, but your model is using loss rates that exceed the historical average? The results of these reflections, at a minimum, support the effective challenge of the model and could even lead to some significant adjustments to how you approach establishing a reserve.

## Establishing model documentation

Estimating expected credit losses under CECL inherently requires a significant amount of judgment – judgment that will need to be explained to stakeholders such as management and regulators throughout the use of your CECL model. Because of this, we can't stress the importance of establishing and maintaining clear and thorough documentation of decisions made during the development and ongoing operation of the model. While many vendors provide white papers and other technical discussions of the theories underlying third-party models, this documentation should be supplemented with a discussion of how management is applying the model and the related decisions, assumptions, and limitations.

As each institution is in a different stage of addressing the new standard, we've outlined additional considerations for those who have already adopted and those yet to adopt below.

## For institutions yet to adopt:

Most institutions yet to adopt this standard are working toward the implementation of a CECL model on Jan. 1, 2023. Below are some key considerations to build into your timeline as you plan for adoption:

- **Data evaluation:** Data availability has been a key consideration in the selection of a methodology and/or model. Understanding the data available and trends in your historical loss rates is a good first step for CECL adoption.
- **Model selection:** The first major decision in selecting a model is determining whether your institution will use an in-house model (often based in Excel) or one developed by a third-party vendor. This decision is often based on an evaluation of the complexity of the institution's loan portfolio, relationships with existing vendors, and the level of ongoing effort to maintain an in-house model vs. a third-party model. The next decision is which method/model to use and should be based on a thorough understanding of the various options being considered. Again, the depth and robustness of data available will likely play a key role in this consideration.
- **Parallel runs:** Institutions benefit from the opportunity to analyze how their CECL model responds to changes over time by running the CECL model in parallel with the incurred loss model for a few quarters prior to implementation. Not only does this provide an opportunity to work out process and model issues ahead of adoption, but many institutions we've worked with have found that it helps them better understand their model and provides an opportunity to adjust, if needed, before implementation.
- **Model validation:** Based on the size and complexity of your institution, a model validation prior to implementation may be expected by management, regulators, and/or other stakeholders. We've observed this process to take about three months to complete, and you may want to schedule this to allow for adjustments to the model and additional parallel runs before implementation of the model.

## For institutions that have already adopted:

Due to the complex nature of many of the models and methods used to estimate credit losses and the importance of this estimate to your institution, many institutions realize that the effort to implement this new standard doesn't stop at the adoption date. As outlined by the regulators, management has a responsibility to perform ongoing monitoring and continue effective challenges of the model and key assumptions throughout the life of the model.

> "Estimating expected credit losses under CECL inherently requires a significant amount of judgment – judgment that will need to be explained to stakeholders such as management and regulators throughout the use of your CECL model.

Several important aspects of ongoing monitoring are outlined below. A process to address each consideration should be established and executed on a frequency commensurate with the complexity of the institution and the model.

- Performing sensitivity analysis to identify key assumptions and verify that the model's response to changes in those assumptions aligns with expectations
- Establishing a framework for the effective challenge of changes to key assumptions, once identified
- Considering how known limitations, overlays, or overrides in your model (for instance, using a floor loss rate in instances where a segment has limited loss history) impact the output of your model at each measurement date
- Completing a model validation in accordance with your institution's model risk management program and when significant changes are made to the model
- Assessing whether inputs continue to be accurate and consistent with the model's purpose and design
- Monitoring the effectiveness of third-party models, including review of SOC-1 reports
- Establishing a plan to complete benchmarking and/or outcomes analysis to evaluate the performance of the model


# Five Pressing Issues for Bankers in 2022

By Shane Ferrell, Vice President
Product Strategy, CSI

To find out how bankers will confront challenges associated with pandemic-induced digital acceleration, cybersecurity, regulatory changes and more, CSI surveyed banking executives from across the nation about their strategies and priorities for 2022. The results of the annual survey are outlined in an executive report and highlight the opportunities — and risks — inherent in today's banking environment.

Here are the top five issues that bankers selected as most likely to affect the industry in 2022, along with strategic recommendations for your institution to consider.

## 1. Cybersecurity Threats Loom Large

With over 85% of banking executives across asset sizes reporting an increase in digital usage at their institution, cybersecurity concerns form an ever-present backdrop. As a result, it should come as little surprise that 26% of respondents selected cybersecurity as the issue they believe will most affect the financial industry in 2022.

Three converging circumstances make cybersecurity increasingly difficult for financial institutions:

- As digital usage increases, more systems and users are vulnerable to cybersecurity threats.
- As more cyberattacks occur, customers are becoming increasingly numb to the risks.
- As institutions enhance their cybersecurity efforts, cybercriminals up the ante with harder-to-detect methodologies.

Some steps, such as routine vulnerability scanning and penetration testing, are no-brainers to enhance your bank's cybersecurity posture. Cybersecurity training is another strategy to prioritize, as banks benefit significantly from an informed customer base. Energize your customers with campaigns, videos and gamification to reinforce the importance of good cyber hygiene.

## 2. Recruiting and Retaining Bank Employees

In a massive shift from previous years' results, recruiting and retaining employees rose to second in bankers' list of pressing issues, taking 21% of the vote. Organizations across industries are feeling the effects of the Great Resignation, and banking appears to be no exception.

With the rise of remote work, prospective employees are now seeking opportunities outside of their geographic region. Larger companies in bigger cities can hire from anywhere and offer salaries far exceeding living costs in smaller communities. This trend causes a unique problem for financial institutions, as turnover leads to a loss of expertise and potentially creates risk from newer, untrained staff.

Your bank should actively seek out new talent while supporting remote work when appropriate to combat these trends. As the talent pool becomes increasingly competitive, consider utilizing trusted 'as-a-service' product offerings and outsourced expertise. For instance, a managed services partner can help optimize your IT infrastructure if IT professionals are unavailable or limited.

## 3. Navigating the Regulatory Landscape

Ranking third with 14% of the vote, regulatory change remains of constant significance to financial institutions, especially given a relatively new administration and a chance of new sanctions. While there is a host of regulatory issues to consider, several of which are

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outlined in the executive report, bankers should continue to stay on top of data privacy. Beyond GDPR, more states are adding privacy regulations, and institutions must take a holistic approach to data privacy, including biometric data.

Additionally, banks must realize that come 2023, there are no more what-ifs regarding CECL. If you aren't already doing so, running your CECL platform parallel to your ALLL platform helps you make strategic decisions about which CECL solution is best for your institution and how it will affect your capital.

## 4. Meeting Customer Expectations

Meeting customer expectations fell to fourth in bankers' priorities this year, but that doesn't mean this issue is any less important. Digital is now the primary way many customers interact with your bank, and that trend will continue.

Even if you're not interacting with customers at your branch at all, you should be able to promote the right products and deepen customer relationships. Digitalizing the customer experience and backend processes make serving customers far simpler.

If you're optimizing existing digital solutions or determining gaps in the populations you serve, data makes all the difference. Whether by CRM or other data and analytics dashboards, analyzing customer behavioral data helps you make informed decisions relating to which markets your bank is serving well and what changes you need to make.

## 5. The Rise of APIs and Open Banking

Open banking APIs are on the minds of financial institutions everywhere as a base technology that enables such game-changes as banking as a service (BaaS), platform banking and embedded banking. It's a simple idea — using open APIs enables third-party developers to build applications and services around your institution.

Open banking APIs offer a host of benefits, including optimization of existing systems, integration with new technologies and opening new revenue streams through platform banking. Further, open banking rounds all banking data and capabilities to give a complete view of customers, driving efficiency and enabling better tools. This includes digital banking, connectivity, workflow integration and even payments.

## Get a Comprehensive Look at Bankers' Top Priorities for 2022

Download the 2022 Banking Priorities Executive Report to unpack the complete survey results — including bankers' insight on their past performance and technological investments — and receive strategic recommendations for the year ahead.

*Shane Ferrell is vice president of Product Strategy at CSI.*

# What Banks and Financial Institutions Should Know about Installment Payments

By Cody Banks
MVP, Payments and Fraud Strategy
Primax

In its early days, Buy Now, Pay Later (BNPL) — or installment payments — started as a subset of consumers searching for more ways to budget and improve finances, but it was rapidly adopted across the board. BNPL quickly became a mainstream payment offering, and today, it is practically ubiquitous: virtually every large and midsize merchant in developed economies has considered, is in the process of launching or has already launched a BNPL solution.

## Today's BNPL Market

One surprising — but generally positive — outcome of the COVID-19 pandemic's effects on the U.S. economy was BNPL lending's rise to stardom. Fast forward to the present, and according to Mercator Advisory Group, more than 50% of U.S. consumers have used a BNPL option in the past 12 to 14 months. And according to the 2021 Primax Payments Pulse, 22% of respondents indicated they would be likely or extremely likely to use a BNPL option if available through their bank. Aite-Novarica's October 2021 Buy Now, Pay Later Market Overview Report notes that installment solutions offered by seven of the leading BNPL vendors currently serve more than 800,000 merchants and over 100 million consumers.

The benefits of BNPL are evident, making it clear why the offering quickly rose to popularity. BNPL offerings allow consumers to play a more active role in managing their financial lives, and they are easy to use and convenient. According to Aite-Novarica, BNPL vendors indicate their merchants see conversion rates improve by 20% to 30%, as offering installment options helps shoppers see a purchase as more affordable, resulting in lower cart abandonment rates. In addition, merchants report experiencing higher basket sizes, with average order value increasing by 40% or more after adding BNPL to their checkouts. Merchant partners also see up to 55% of BNPL users making repeat purchases.

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Per Aite-Novarica, BNPL retail e-commerce volume was approximately $500 billion in 2020, up 28% from 2019. At the end of 2020, BNPL spending in retail e-commerce was projected to grow to more than $1.2 trillion by 2024, a 25% compound annual growth rate (CAGR). In actuality, total BNPL spend by that point is likely to be even higher than originally projected when considering the recent expansion of BNPL offerings, which includes the physical point of sale (POS), Square's acquisition of Afterpay, PayPal's entry into BNPL in late 2020, Amazon's partnership with Affirm and the proliferation of BNPL providers targeting non-retail verticals.

## Recommendations for Banks and Financial Institutions

As online purchases continue to grow exponentially, consumers are beginning to appreciate — and in some cases come to expect — the ease of use associated with BNPL. Demand for this convenient payment option has grown tremendously and is expected to increase.

With that in mind, the BNPL market is a space worth considering for community banks when it comes to growing portfolios, attracting new account holders and creating more solution offerings. The call to action was clear in a recent PYMNTS.com survey released last month, where three-quarters of consumers who use BNPL from the top three providers were interested in switching to a financial-issued plan.

Banks and financial institutions should create a plan to best approach implementing a BNPL offering. First, choose and develop your installment plan through a BNPL vendor. Options include pre-purchase (consumer opts-in for installments prior to making the purchase), at-purchase (consumer is prompted at merchant checkout to pay with installments) or post-purchase (consumer converts a recent credit card purchase into installments). For a financial institution's first BNPL offering, pre-purchase or post-purchase are recommended. Card issuers have more flexibility with these plans based on cardholder history, existing credit lines and regular cardholder interactions.

Once your plan is in progress, consider the following steps:

- **Promote**: Execute promotional activities to position your institution's debit or credit card as the card of choice among customers interested in setting up installment plans. This will continue to drive interchange revenue, deposit balances and brand visibility for your institution.
- **Partner:** Facilitate partnerships between your merchant account holders and BNPL providers. For merchants, the best way to drive loyalty is to help them optimize their businesses, and installment payment options are well on their way to becoming a necessity for businesses everywhere. Consider partnering with a trusted BNPL provider and leveraging their analytics to meet account holders where they are in their financial journeys. Remember that consumers expect a digital-first experience, so any product launch should be embedded in this journey.
- **Educate:** Take the opportunity to educate account holders about BNPL offerings and why solutions like this can benefit their overall financial wellness, providing them with an additional budgeting tool to better manage their finances.

The future of BNPL is only going to grow from here, so now is the time for financial institutions to begin planning for and launching these offerings to customers in order to continue growing and succeeding in the current financial services market.

*Cody Banks leads Primax's payments, fraud, loyalty & contact center product teams. In his role, Cody focuses on developing and delivering safe, easy and convenient payments experiences for the company's financial institutions. Prior to joining Primax in 2017, Banks spent nearly 10 years in the credit union industry navigating complex initiatives with a focus on journey mapping of the cardholder experience.*

# ESG Initiatives in Banking: How They Impact Consumer Loyalty

By Paul Davis
SRM (Strategic Resource Management)

Environmental, Social, and Governance (ESG) factors are playing an increasing role in decision-making at banks.

Climate considerations — whether the result of government mandates, shareholder activism, or environmental shifts — have altered risk assessment models. Additionally, the prospect of regulators adding ESG metrics to examination criteria is gathering steam.

ESG's most immediate impact on the banking industry's bottom line, however, may come via the court of public opinion.

SRM has been studying the drivers of consumer loyalty as part of a research initiative we began in 2012. Our recent report, based on data collected in July 2021, offers clues on the extent to which bank fortunes hinge on customer perceptions in areas including ESG.

## Walking the Climate Talk

SRM's research reveals subtle nuances between why consumers choose a given bank (or credit union) and why they elect to stay with their financial institution. Quality service continues to rank at the top of both lists. However, an institution's reputation plays an essential role in the initial selection.

Our study further indicates that "commitment to climate change" is one of the largest influencers of consumer loyalty — although most banks must generate significant boosts in their ESG ratings to benefit.

Several banks have taken steps to establish such credentials. Those efforts include establishing an ESG business unit and creating a post to oversee environmentally and socially responsible investments. Another large bank offers a commercial deposit product that lets clients direct cash reserves to finance socially and environmentally sustainable projects. While their efforts may focus largely on commercial and investment banking activities, it shows that multi-national institutions recognize the value of brand positioning and may be ahead of the curve on what seems to be an inevitable U.S. trend.

ESG activities aren't confined to the largest national banks. A community bank in Northern California formed an internal climate change committee to assess climate risk in its portfolio.

## Social Impact Segmentation

To date, SRM's research indicates that a financial institution's commitment to social impact, including climate change, resonates most strongly in the brand perception of smaller banks. It appears that U.S. banking customers have already largely self-selected; in other words, those who prioritize social impact have affiliated with smaller or more niche banks. Perhaps surprisingly, the attitudes of neobank customers do not reveal social impact as a strong motivator.

If ESG factors gain ground in U.S. consumers' decision-making and large institutions continue to burnish their credentials in this area, it's easy to envision accounts shifting away from smaller banks that happen to overlook similar initiatives. Since ESG particularly resonates with the 25-34 cohort, the long-term growth implications could be significant.

The variables that drive consumers' banking relationships are continuously evolving and are increasingly influenced by experiences outside the financial sector. SRM's customer loyalty report offers valuable insights to inform financial institutions' strategic decisions. Naturally, there are many factors beyond account retention to consider when forming an ESG policy. Nonetheless, a complete understanding of the overall landscape is always a good input for strategy formulation.

*Paul Davis is Director of Market Intelligence at SRM (Strategic Resource Management). He has more than 20 years of experience following financial institutions. Before joining SRM, he was the editor of community banking and M&A at American Banker, supervising the publication's coverage of banks with up to $20 billion of assets.*

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