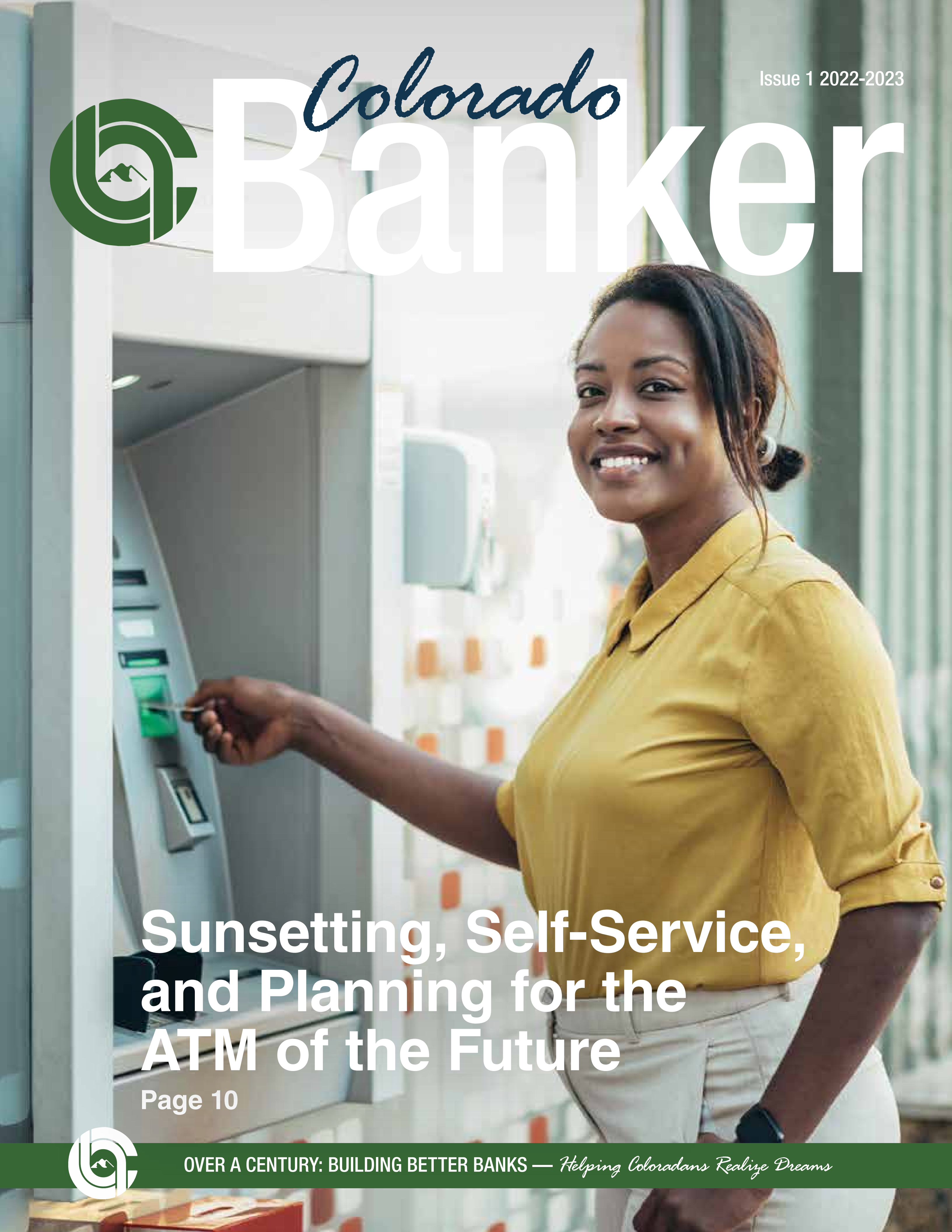


Issue 1 2022-2023

Colorado Banker

Sunsetting, Self-Service, and Planning for the ATM of the Future

Page 10

OVER A CENTURY: BUILDING BETTER BANKS — *Helping Coloradans Realize Dreams*

Contents

Over a Century

BUILDING BETTER BANKS—
Helping Coloradans Realize Dreams

Jenifer Waller
President & CEO

Alison Morgan
Director of State Government Relations

Brandon Knudtson
Director of Membership

Lindsay Muniz
Director of Education

Rita Fish
Communications & Office Manager

Margie Mellenbruch
*Bookkeeper**

Craig A. Umbaugh
*Counsel**

Jim Cole
*Lobbyist**

Melanie Layton
*Lobbyist**

Garin Vorthmann
*Lobbyist**

Andrew Wood
*Lobbyist**

** Outsourced*

140 East 19th Avenue, Suite 400
Denver, Colorado 80203
Office: 303.825.1575

Websites:
coloradobankers.org
smallbizlending.org
financialinfo.org

colorado-banker.thenewslinkgroup.org

THE newsLINK group

A Word From CBA

By Mark Hall, SVP, Sr. Community Bank Division Leader, Vectra Bank, 2022-2023 CBA Chairman

Navigating Success Through Tumultuous Times

We have all heard the political pundits and experts tell us that “post-pandemic,” the economy will perform in such-and-such a way. The past few years have not performed as any of us could have predicted ten, or even five, years ago. Would any of us have considered the potential for $10 per gallon of gas or the increasing cost of a weekly trip to the grocery store? These are unprecedented times, and it is at times such as this that we can rely upon CBA to provide value to the membership.

It is an honor to be elected by the membership to be the 2022-23 Chairman of the Colorado Bankers Association. These may not be ideal economic times to be chairman of CBA, but it will be exciting, nonetheless. There remain opportunities to make a positive difference for our industry and Colorado.

Through 20 years in banking, I have experienced the challenges of economic highs and lows. We enter this latest downturn with regulatory agencies focused on further restricting the means by which we conduct our business.

Now more than ever, we need CBA to be at the forefront of advocacy and our watchdog for regulatory stability. As a well-regarded and respected association, CBA will represent the voice of our industry as we navigate through these challenging times in Colorado and our nation.

During my tenure as chairman, it is my goal for CBA to focus on four areas:

Advocacy and Government Relations: CBA is a leader and provides a strong, reliable voice at the state house in Denver and in D.C. on behalf of the financial service industry. During the next year, CBA’s work to protect the interest of banking in Colorado and before Congress and regulators will be critical.

Education and Professional Development: A tremendous member resource is education and professional development offered through CBA. I am a 2016 graduate of the Center for Banking Advocacy. This is an excellent program for introducing and engaging bankers in the legislative and advocacy process. Over the next year, CBA will expand its professional development program with increased participation from member banks.

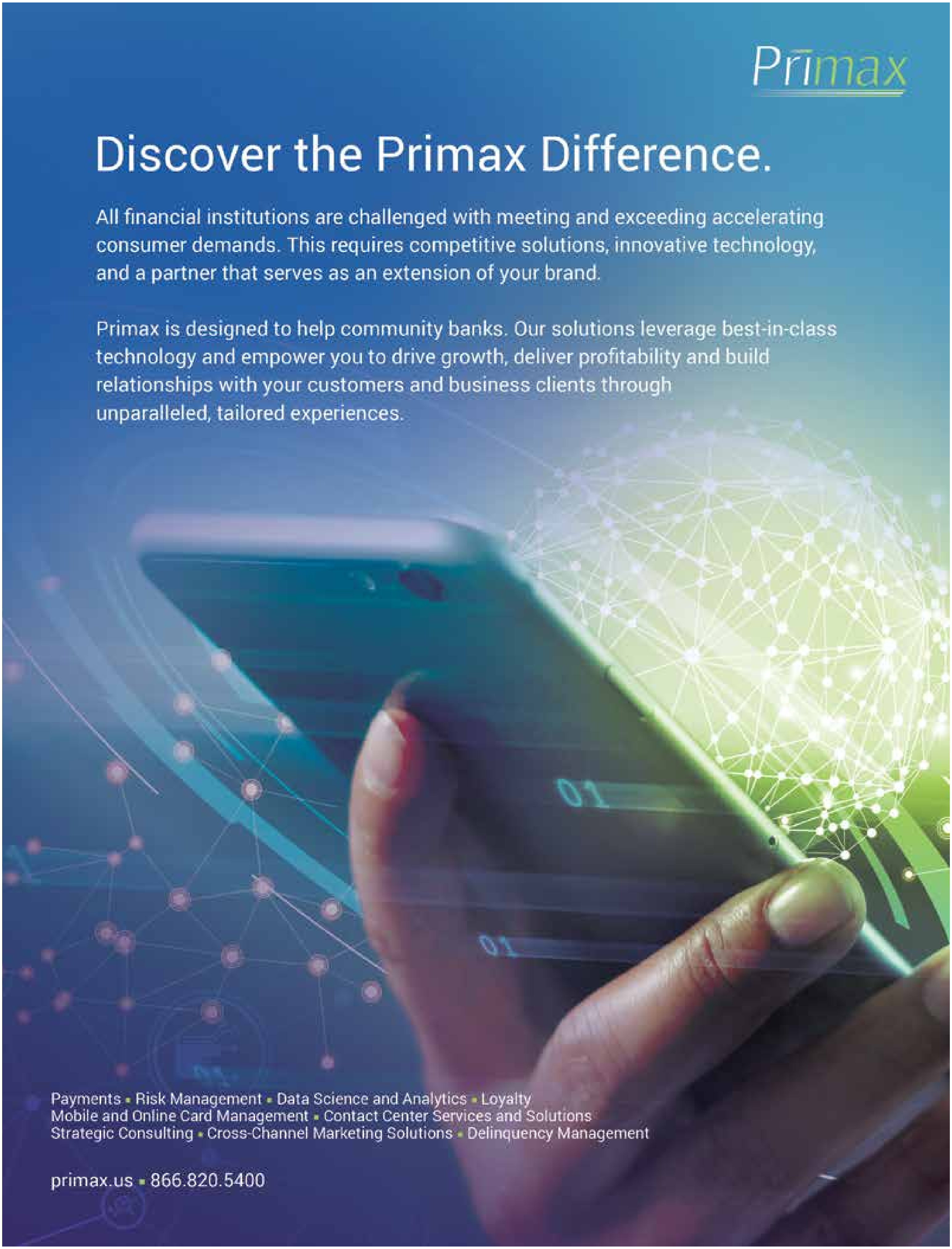
Membership: CBA staff is responsive to the membership and provides exceptional customer service. Over the next year, they will continue to support our member banks, so your membership is more than you ever expected. For a robust and diverse association, we will continue to grow our member banks.

Banker Resources: Our CBA staff accomplishes so much with so few staff on hand. My goal is to begin an online Banker Resource which will be a catalog of content that can be shared by our members and teach banks and bankers how to leverage and utilize resources within CBA. More information on this project will follow in the months to come.

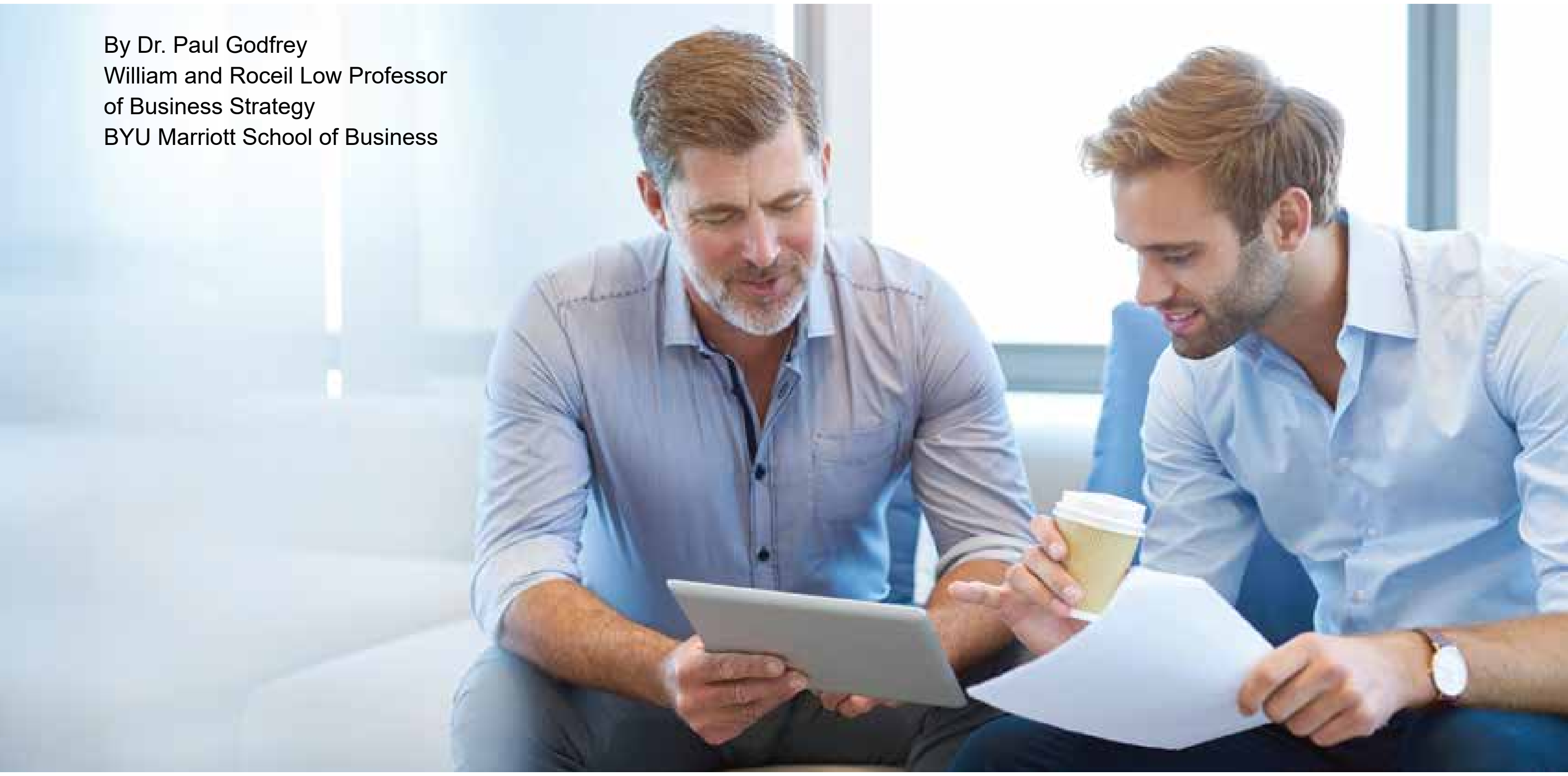
“My goal is to begin an online Banker Resource which will be a catalog of content that can be shared by our members and teach banks and bankers how to leverage and utilize resources within CBA.

We have strong leadership with Jenifer Waller at the helm, and she has built a solid team to support the mission of improving the quality of the Colorado banking industry and enhancing its ability to compete effectively and efficiently.

I am excited to share this next year with you. I am encouraged that with CBA as a partner and advocate, we can conduct good business for Colorado and continue to promote a sound and competitive banking environment.


Primax
Discover the Primax Difference.
All financial institutions are challenged with meeting and exceeding accelerating consumer demands. This requires competitive solutions, innovative technology, and a partner that serves as an extension of your brand.
Primax is designed to help community banks. Our solutions leverage best-in-class technology and empower you to drive growth, deliver profitability and build relationships with your customers and business clients through unparalleled, tailored experiences.
Payments • Risk Management • Data Science and Analytics • Loyalty
Mobile and Online Card Management • Contact Center Services and Solutions
Strategic Consulting • Cross-Channel Marketing Solutions • Delinquency Management
primax.us • 866.820.5400

The Society of Bank Executives:
The Power of Peer Networks



By Dr. Paul Godfrey
William and Roceil Low Professor
of Business Strategy
BYU Marriott School of Business

As you know, leading a bank today has never been more challenging; to borrow a phrase from an old General Motors advertisement, "It's not your father's bank." You and your team work harder than ever to generate income through traditional lending activities and a growing portfolio of services. If that isn't difficult enough in a post-pandemic, politically-charged, inflationary environment, you find yourself swimming in change, from climate investing and disclosures to cryptocurrencies to ever-evolving ransomware risks.

Bank leaders need to sharpen a different set of skills to master today's challenging environment, and successful leaders understand the critical role a vibrant peer network plays in providing perspective, identifying solutions, and accelerating learning.

We've engineered the Society of Bank Executives around the connection between meeting today's challenges and creating a vibrant peer network that leads to solutions and success.

The Art of Running a Bank

The training bank executives receive on the way up the organizational ladder typically focuses on "blocking and tackling" – the hard skills that constitute the "science" of running a bank. But the challenges that keep you up at night require knowledge and skill in the "art" of leading a bank – things like building teams, trust and culture, motivating, mentoring and coaching, and creating and deploying strategy.

The Society of Bank Executives helps you develop and expand these critical skills, not just amass information. This development happens the same way we truly learn any skill – through an intentional, peer-supported process that engages us "many times in many ways." We host premier content experts virtually to expand your knowledge of the art of leadership. Then we hold a two-day in-person event, where you'll apply the skill in simulated and real situations. We'll put you in a group setting where you'll work with other bank executives on a skill-based case study, and you'll create an action plan for your bank to focus on over the next month. You can leverage your peer group for advice and feedback, and you'll return the favor by helping them formulate realistic and robust plans. You'll complete the process by reflecting on your experience with that same peer group. This simple, iterative process of Learn-Apply-Reflect forms the foundation of the Society's development program. The Society spreads this process over a six-month period, covering two skills per calendar year.

The Power of an Intentional Network

We all have a loose network of people to whom we turn for advice. Fewer of us have a vibrant professional network with executives who understand and have experienced the challenges we face in banking, and who we can be open with and turn to because they are non-competing peers. A vibrant network doesn't grow out of random or one-off connections; it comes about as we intentionally develop meaningful relationships with others, grounded in solving real problems and challenges. In today's hyper-busy world, you don't build a vibrant network by attending cocktail parties or networking events, but rather through sustained interactions where you work on creating change, both in yourself and in your bank. The aforementioned in-person event – held twice annually in conjunction with our skill development program – will help you expand this vital network. In small group settings, you'll work with other bank executives on applying the skill and creating a plan to continue to develop it in the future. In your peer group, you'll seek and provide advice and feedback, as well as strengthen your own network. Peer groups will rotate on a regular basis to further strengthen your opportunity to network with other executives in meaningful ways. You'll also have the opportunity to deepen those relationships through participation in joint activities, meals, and informal discussions over the two days.

If you are not managing "your father's bank," then your father's approach to developing peer networks and executive skills probably won't lead to success in today's banking environment. The goal of the Society is to help you, your executive team, and your bank to learn, grow, and thrive in an ever-changing and complex marketplace.

Dr. Paul Godfrey is the Development Advisor to the Society of Bank Executives. Learn more and apply now at executives.bank.

Third-Party Relationships:
Due Diligence Guidance for Community Financial Institutions Engaging Fintechs

By Brad Birkholz, Senior Manager
and James Siegel, Senior Manager
Plante Moran

New federal guidance has clarified steps community financial institutions should take when contracting with a financial technology service provider. Banks that rely on fintechs, and those considering new relationships, should take time to understand the expectations.

Today's community financial institutions see more opportunities than ever to enter into relationships with a new generation of financial technology (fintech) companies, including those offering robotic process automation solutions. Community financial institutions are no strangers to engaging technology companies that assist with various business needs – such as core systems and IT infrastructure – but these next-generation fintech partnership opportunities present new risks because the products and services they offer are new to the marketplace.

> "Fintech relationships are often (although not always) customer-facing partnerships. They enable community financial institutions to provide a new product or service, access a new customer base, or enhance efficiencies.

Until recently, the regulatory guidance governing third-party risk management expectations for financial institutions has been spread across several different federal agencies.

The expectations could vary depending on whether the institution was regulated by the Office of the Comptroller of the Currency (OCC), the Federal Reserve Board (FRB), or the Federal Deposit Insurance Corporation (FDIC). This year, the agencies released proposed interagency guidance on risk management for financial institutions entering into third-party relationships, followed shortly afterward by a guide for community banks that need to conduct due diligence on fintechs. Community financial institutions need to understand this recent guidance and take action to ensure that their third-party risk management programs properly address the relevant risks in fintech relationships.

A new type of third-party relationship

Partnering with a fintech can be a different risk management experience than partnering with other IT providers. Many community financial institutions have developed third-party risk management processes for their relationships with traditional technology partners. These traditional technology partners have typically provided "standard" IT solutions focused on basic day-to-day "back-office" functions like processing transactions. They usually offer these fundamental services to institutions for less than it would cost each bank to keep the process in-house.

Fintech relationships are often (although not always) customer-facing partnerships. They enable community financial institutions to provide a new product or service, access a new customer base, or enhance efficiencies. Financial institutions can't necessarily depend on their technology partners to educate them on the process of partnering with a fintech. These companies are nimble organizations that can change dramatically in short spans of time. As fintechs race to get their products to market ahead of their competition or launch a new version with the latest enhancements, compliance with federal banking regulations probably won't be their top priority. Their culture and business processes may vary greatly from the community financial institutions they partner with and from the traditional technology companies that community financial institutions are used to working with.

New guidance for managing these new relationships

In response to the rise of this new type of relationship between community financial institutions and fintech companies, the federal regulatory agencies that oversee America's financial institutions issued proposed interagency guidance on managing risk in third-party relationships. Shortly thereafter, that regulatory language was followed by a guide focused specifically on helping community financial institutions understand how to conduct due diligence on fintechs under the new guidance. The guide offers relevant considerations, potential sources of information, and helpful examples on the following six key due diligence topics:

- Business experience & qualifications
- Financial condition
- Legal & regulatory compliance
- Risk management & controls
- Information security
- Operational resilience

This action by regulators should streamline the third-party due diligence expectations for all financial institutions.

Continued on page 8

Continued from page 7

The guide should help community financial institutions understand how their processes may need to be modified to perform due diligence on their relationships with fintech companies.

Two types of community financial institutions

At this point, there are two types of community financial institutions in the United States: those that have relationships with third-party fintech companies and those that are going to have relationships with third-party fintech companies.

For those with existing contracts, this guidance serves as a wake-up call that the third-party risk management used in the past for relationships with traditional technology partners needs to be reviewed to make sure that they are properly vetting fintech providers. For those that don't yet have relationships with fintech companies, the guide highlights six key due diligence areas in which their third-party risk management process should be reviewed and possibly enhanced before entering into agreements with these service providers.

For many community financial institutions waiting for this guidance in order to start considering relationships with fintechs, the availability of these new expectations could be just the push needed to get them into the market. Still, many community financial institutions aren't well versed in this relatively new guidance and the potential impact it could have on their third-party risk management programs.

Community financial institutions need to read and understand this new joint regulatory guidance. Many will need to update their third-party risk management programs to specifically address fintechs and their risks. Those with fintech relationships in place need to determine how this guidance affects their existing relationships and take additional steps to address any gaps.

As an accounting and consulting firm known for our breadth and depth of technical knowledge and industry expertise, Plante Moran can help your institution with this process, either by performing third-party compliance reviews of potential fintech companies or reviewing a financial institution's third-party risk management processes for compliance with the new expectations. If you have any questions about this guidance, please contact Plante Moran.

CHIPPEWA VALLEY BANK

TIRED OF BORROWING MONEY BEING MORE COMPLICATED AND DIFFICULT THAN IT NEEDS TO BE?

Bank Stock and Bank Holding Company Stock Loans Done the Simple Way

Bank mergers, acquisition loans and refinances up to $50 million

1. Calling us is the first step.

3. CVB preparing the loan documents generally within 5 to 10 days.

5. CVB wires the funds.

2. You email us the appropriate docu-ments of information.

4. Meeting the customer. We will come to you to sign loan documents.

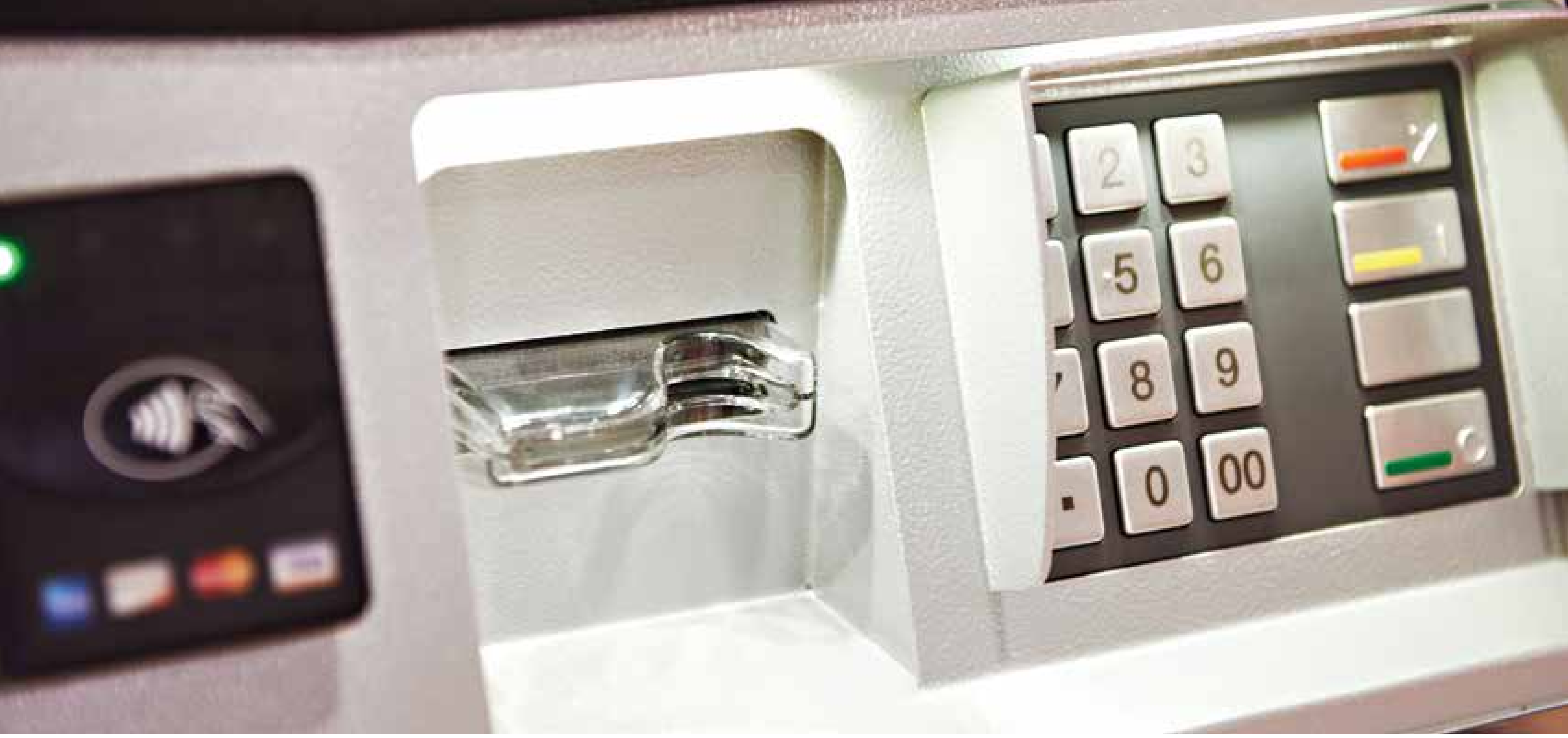
6. Wow that was easy.

» **Call Rick Gerber or Ryan Gerber at 1-866-282-3501 or email**

rickg@chippewavalleybank.com
ryang@chippewavalleybank.com

FDIC

EQUAL HOUSING LENDER



Sunsetting, Self-Service, and Planning for the ATM of the Future

By Joe Woods, SVP
Marketing & Partnerships
Dolphin Debit

As if maintaining your ATM fleet didn't come with enough headaches and expenses, the imminent sunsetting of the most widely used ATM hardware/software in the U.S. is forcing banks to re-evaluate their fleet and ATM strategy going forward.

Two of the largest ATM manufacturers in the U.S. have announced plans to discontinue support, or "sunset," their most popular ATM products. This means roughly 50% of U.S. ATMs will need to be replaced or upgraded within the next two years and it comes with a hefty price tag. Chances are your bank falls into the majority that will be required to pour additional investment into an ATM fleet that already comes with a laundry list of expenses and tedious management tasks that eat away at precious staff time and capital.

While banks weigh their options on how to handle the sunsetting of their ATMs, it's also important to keep in mind the shift we see in the financial services landscape. Meaning: how do your ATMs fit into the digital era and the self-service expectations of your account holders? What hardware should you be considering to future-proof your investment? When and where should new machines factor into your plans? The list goes on.

How and when to invest in ATM fleets is becoming a growing topic as banks of all sizes are looking to the future, laying out their plans for "digital branch transformation" and incorporating more advanced and sophisticated ATMs into those plans. These new machines may be deposit-taking ATMs, "future-proofed" ATMs with equipment that streamlines upgrades when needed, or they could be the top of the line: Interactive Teller Machines (ITMs).

Which asks the new question: Should ITMs be implemented into your plans?

We see heightened interest in banks eager to leap to ITMs, and who can blame them? This is the direction the financial services world is being pulled by digital consumers who demand convenience and self-service. ITMs also allow banks to extend service hours, increase their footprint with mini-branches, and reduce staff and overhead costs per transaction. But, ITMs come with

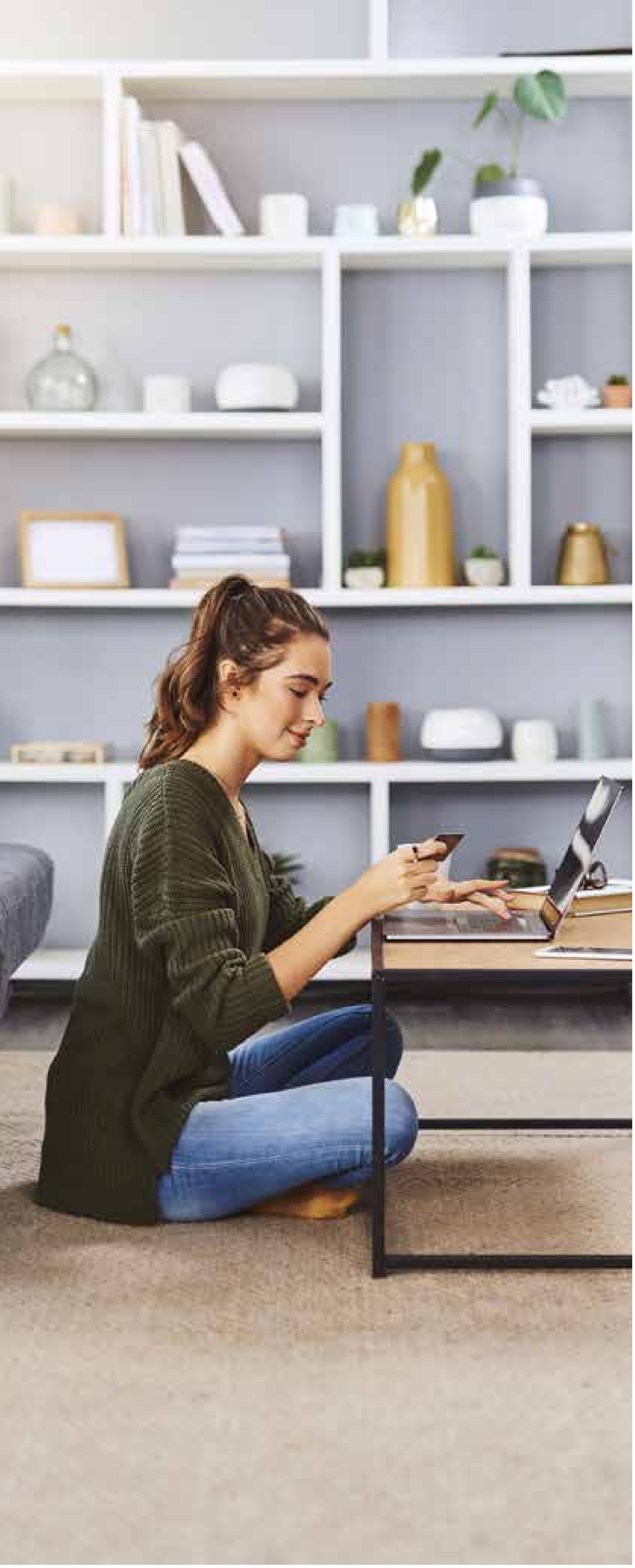
> While banks weigh their options on how to handle the sunsetting of their ATMs, it's also important to keep in mind the shift we see in the financial services landscape.

a significant investment, so many banks are taking an interim step into a future-proofed ATM carrying hardware that is easily upgraded for seamless ITM conversion down the road.

The looming sunsetting of ATMs means the clock is ticking, and pressure is being put on banks to make buying decisions regarding their ATM fleets. But, as we have discussed, decisions made now will have a big impact on consumer service capabilities for years, and investment should be carefully considered to align with your long-term ATM/ITM strategy.

With staff and budgets stretched thin, your bank simply may not have the capacity to prioritize your ATM/ITM strategy. You're not alone, and there are options available to help guide your institution through the changing ATM/ITM technology and self-service expectations. ATM Outsourcing, ATM Managed services, ATM-As-A-Service, or any other way you want to define the solution makes more sense now than ever. Change is rapid, and consumer expectations are shifting. Now is the time to adapt and position your financial institution for success in the digital era.

Dolphin Debit's fully funded, turnkey approach to ATM outsourcing has proven to be the ultimate tool for financial institutions to seamlessly adopt new ATM/ITM technology and maneuver ATM sunsetting plans without sacrificing precious capital. Whether you have ATMs looming sunset, outdated machines, or want to explore ITMs, Dolphin Debit will provide the capital necessary to upgrade machines or replace them with brand new equipment on your behalf. A suite of ATM management services combined with expert consulting removes the burden of operations from staff. It assures your ATM/ITM strategy is poised to align with your short and long-term institutional goals.



Effective Credit Risk Monitoring in the Post-Pandemic Economy

By John McKay, Senior Manager
and Kevin Garcia, Senior Manager
Plante Moran

As COVID-19 continues to affect individuals, communities, and global economies, financial institutions must continually adapt their credit risk monitoring strategies to effectively identify as quickly as possible those loans that have increased in risk. These strategies can help.

The COVID-19 pandemic forced individuals and businesses to continually adapt to a "next normal," and financial institutions are no exception. While credit risk in the banking industry has, for the most part, remained surprisingly stable throughout this volatile time, the pandemic has driven significant changes in the way financial institutions evaluate credit risk and monitor for signs of deterioration in their existing loan portfolios.

Loan approval is just the beginning of credit risk monitoring

Prior to COVID-19, most financial institutions could reliably determine how they would monitor a loan's performance and assess changes in the borrower's risk profile when they approved the loan. Lenders could use the information gained from the application process to determine what tests could effectively monitor the loan and how frequently to apply them. Tried and true methods could range from an analysis of tax returns and financial statements on an annual basis for low-risk loans to more frequent and thorough tools such as covenant compliance checks, evaluation of borrowing base certificates, or the preparation of quarterly or even monthly financial statements. Smaller or less risky loans may be handled on an exception basis only, requiring action only when adverse information is received, such as notification of a judgment, lien, or low credit agency score.

The pandemic has driven home to lenders just how quickly the quality of a loan can deteriorate and how ineffective some of the common tools can be at identifying changes in risk. In addition to the standard reporting requirements that community lending institutions have relied on to monitor the ongoing risk associated with a loan, the following indicators have come to the forefront during the pandemic as helpful early warning signs of potential problems:

- Rent rolls that provide information on tenants and rents in commercial property can be extremely helpful in assessing the ongoing repayment capacity of the borrowers. They can be particularly useful during the first quarter of the year as a proxy for annual tax return reporting, which is frequently delayed by extensions of the filing date.
- Verification of liquidity for borrowers or guarantors is considered a significant factor in the underwriting decision.
- Use of Smith Travel Research, or "STR," reports for hotel/motel borrowers monitors trends in occupancy, average daily rates, and competitive market position.
- Site inspections verify property condition and occupancy, which also helps detect any potential deferred maintenance and needed capital expenditures.
- Field audits verify accounts receivable and inventory for borrowing base lines of credit.

Communication is key

In light of the ongoing macroeconomic pandemic-driven challenges affecting commercial and agricultural enterprises, it's critical for lenders to combine continued credit risk diligence with enhanced borrower communications. Financial institutions can get a much better understanding of changing risk profiles when they talk to borrowers on topics including:

- Constraints on production or service delivery due to supply chain disruptions, such as a lack of raw materials, component parts, or labor;
- Unexpected weather events such as hurricanes, floods, or wildfires that affect industrial output;
- Inflation pressures affecting costs of production and the (in)ability to pass these increased costs on to end consumers; and
- Crop insurance for agricultural production.

It's also important to remember that even when these challenges don't apply directly to a specific borrower, they can still indirectly impact the supply chain or customer base that a borrower counts on. For instance, if a large customer of a borrower is affected by a natural disaster or a COVID-19 outbreak, that customer may be unable to purchase products as previously agreed.

Don't overlook the basics

Lastly, it's important for financial institutions to remember the following monitoring items that may have been put on the back burner while they were addressing the more immediate risks brought about by the pandemic:

- Succession planning for small business or family-owned enterprises where management is concentrated in one or among a few key personnel;
- Tax implications that could arise from the Build Back Better Act or other future legislation.

These basic components of credit risk haven't disappeared just because businesses have been struggling with more immediate day-to-day challenges of the pandemic.

Without a doubt, the pandemic has touched just about every aspect of the business operations of our clients, and the lending area is no exception. It's important your credit risk monitoring process relies on both time-tested and newly relevant tactics to help your credit management team remain vigilant in the pandemic landscape.

Cyber Awareness:
Decreasing the Cost of a Cybersecurity Attack

By Stephen J. Cosentino, CIPP
and Perry L. Glantz
Stinson, LLP

Class action plaintiffs have plenty of ammunition when pointing a finger at a company holding consumer data. An attack occurs, typically because of a security vulnerability and/or a novel method, and plaintiffs have a somewhat easy avenue to establish causation. For that reason, many companies and banks understandably focus their efforts on beefing up their information security policies and procedures. Pro-active banks and other companies wisely engage cybersecurity forensic consultants, procure quality cyber liability insurance, and ramp up their response plans to help establish reasonable precautions that can help counter causation arguments. However, with the rising number of data breaches in recent years exposing millions of consumer data records to potential identity thieves, the supply of consumer information – Social Security numbers, account numbers and other personal information – on the black market has exploded. That makes damages difficult to prove in data breach cases because of the high likelihood that the individual's personal data is out there somewhere.

It was only a matter of time before creative damages theories would arise in these cases. In a recent decision, a federal district court certified a class in a case based upon a data breach in which a massive amount of personal identifiable information (PII) was stolen over the course of several years. One notable element of this class certification order is that it is founded, at least in part, on a novel theory of damages. This theory is based on the premise that the amounts charged by the

Continued on page 16

> Engage in a data mapping exercise to have a full understanding of where all of your consumer personal information is stored and who has access to it.

Continued from page 15

company that suffered the data breach would have had to have been reduced if the relevant market consumers were aware of the company's failure to protect consumer data. In other words, if the market knew this company was subject to the ongoing data breach, it would have had to lower its prices in order to attract customers. Thus, the theory is that the members of the class should be able to recover these theoretical overcharges for payments they made to the defendant company during the ongoing data breach. This theory of damages allows for recovery without any evidence of the actual misuse of a consumer's PII as a result of the data breach.

The case in which this theory of damages has been accepted involves the price charged for hotel rooms; however, one can easily imagine how this might apply to other industries, e.g., airline ticket prices. With the high level of security involved in air travel today, a great deal of information most people consider very confidential is required to purchase a ticket on an airplane. If one airline made no promise to protect the PII collected from their customers, it would probably have to charge much less per ticket than a competitor using state-of-the-art data breach protections. Who would knowingly provide their confidential information to the clutches of the dark web? A similar analogy can be made in the banking industry. If it was known that a bank was subject to a data breach or a ransomware attack, arguably, even a complete waiver of fees charged for banking services would not keep customers at the bank while their confidential financial information – and maybe their money – is siphoned off. Could this theory of damages subject a bank that suffers a data breach to a complete disgorgement of fees collected from all of the customers impacted by the breach?

As this theory of damages continues to play out in court, companies can take steps to minimize its viability. Experts in the cybersecurity field often start their presentations with the phrase "It is not if but when a cybersecurity incident will occur." There is certainly some truth to that statement. Threat actors increasingly deploy sophisticated attacks that focus on weaknesses in both people and in systems. Making your bank 100% protected is nearly impossible; however, engaging in proactive measures consistent with best practices in the banking industry can go a long way to establish that data protection efforts are a significant part of the cost of doing business.

With threat actors using more sophisticated phishing attacks and payment fraud schemes, it is important to provide ongoing cybersecurity awareness training to employees to counter new attacks. Employers should keep thorough records of your training and the amount of time and expense involved.

Access controls, encryption, intrusion detection and vendor diligence should make up a significant part of the time and expense your bank contributes to its information security program. Access can be a difficult issue with employees working remotely and wanting the flexibility to use mobile devices. Each device presents an additional point of vulnerability, emphasizing the need for mobile device management, multi-factor authentication, technical measures preventing local storage and other controls. Encrypted data is usually an exception under data breach notification laws. Failing to encrypt data in transit and in storage makes for an easy argument by class action plaintiffs.

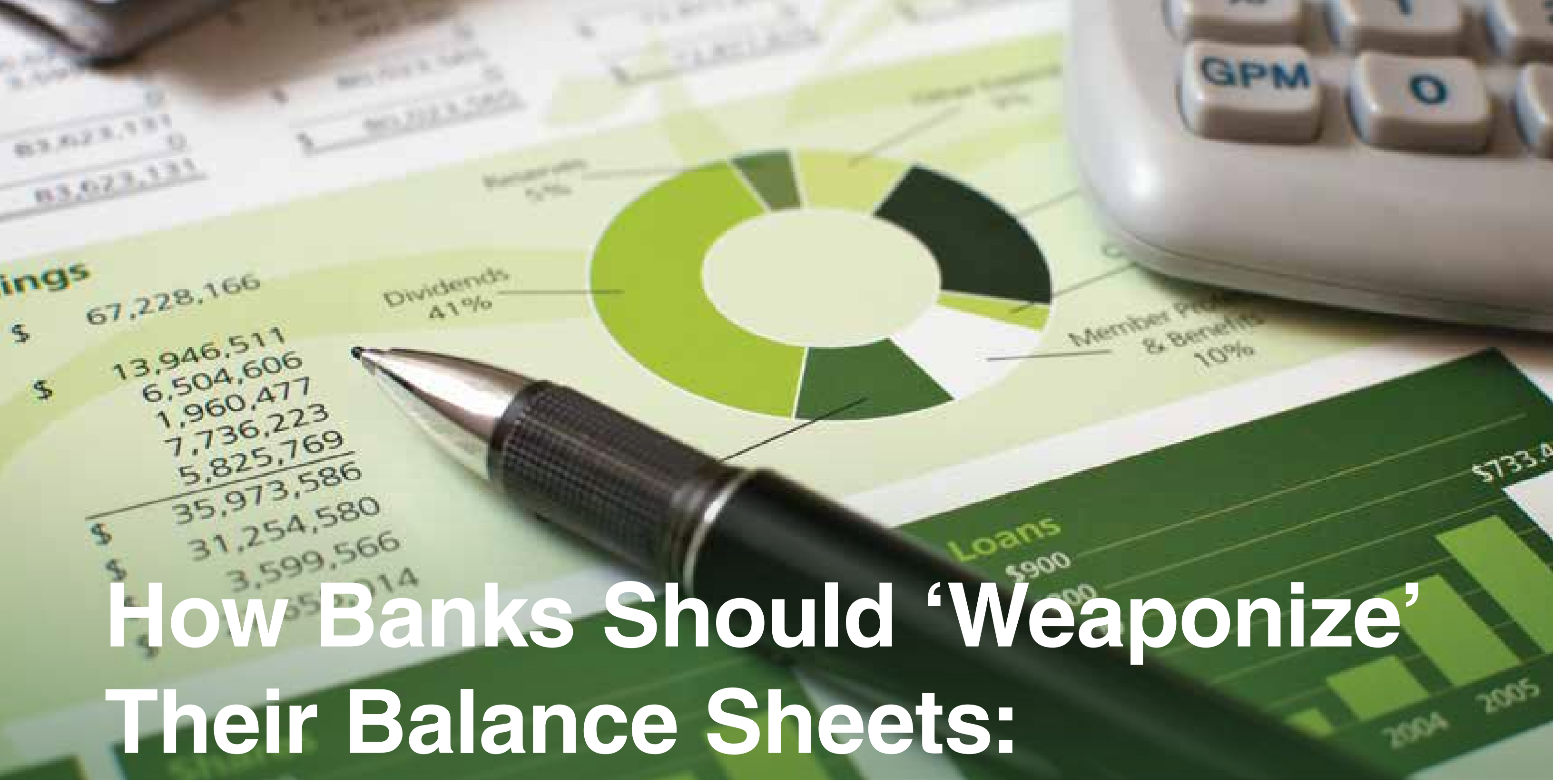
While many banks have an internal information security team or use an information security vendor to monitor intrusions, sophisticated threat actors develop new attacks every day. Consider engaging a firm that also does cyber forensic investigations, as they will often have recommendations for the latest threat detection technology.

Both regulators and plaintiffs' attorneys almost always make an issue of the amount of time it takes between the first indication of a security incident and notifications to consumers and regulators. Usually, there is a good reason for some of this delay: It takes time to investigate and determine whether a breach actually occurred and the scope of the incident. Samples of data from ransomware attackers and other threat actors are unreliable, resulting in significant time spent to determine what may have been exposed. However, there are many parts of this process that can be controlled and expedited by your bank. Have a cyber-forensic firm engaged and on retainer. Make sure you fully understand your insurance coverage and how to quickly invoke it. Engage other vendors, like notice services and call center services, ahead of time to make the notice process more expedient. Hire a PR firm to help get ahead of messaging. Engage in a data mapping exercise to have a full understanding of where all of your consumer personal information is stored and who has access to it. Conduct run-throughs of your cyber incident response plan to ensure that it can be quickly invoked and followed.

Finally, with this new theory of damages gaining steam, it may make sense to address it in your customer contracts. Have your customers acknowledge that while the bank is committed to protecting your personal information, and goes to great expense to do so, no information is 100% secure. Data breaches are inevitable, but with a solid prevention program and good documentation on all of the internal and external costs of your program, you will have a much better defense that the ticket was worth the price of admission.

Stephen J. Cosentino, CIPP, is a partner at Stinson LLP in the firm's Kansas City office. He may be reached at steve.cosentino@stinson.com.

Perry L. Glantz is a partner at Stinson LLP in the firm's Denver office. He may be reached at perry.glantz@stinson.com.



How Banks Should 'Weaponize' Their Balance Sheets:

A Q&A with Piper Sandler's Scott Hildenbrand

By Rob Blackwell
Chief Content Officer
IntraFi Network

The end of the great deposit flood may soon be nigh. Since the pandemic, banks have been saturated with liquidity due to a flight to safety and government stimulus. In December 2019, just before the pandemic started, total commercial bank deposits were roughly $13.3 trillion. Within a few months, by May 2020, they had jumped 16% to $15.4 trillion. By April 2022, they were over $18 trillion.

While initially beneficial, the influx of deposits is proof of the adage that you really can have too much of a good thing. Banks have been awash in liquidity without much loan demand to deploy it. But with the Federal Reserve raising rates and rate-sensitive customers beginning to pull their deposits, bankers are wondering how sticky those customers — and deposits — will be. Combined with geopolitical events and the fact that the pandemic remains ongoing, the future is uncertain.

So what should banks be doing now, and how can they best prepare no matter what happens next? On our podcast, Banking with Interest, we sat down with Scott Hildenbrand, chief balance sheet strategist at Piper Sandler, to find out the answers to those questions.

Following is our conversation, edited for length and clarity:

The Fed raised rates by 50 basis points at the last meeting and signaled it could keep moving aggressively until inflation is under control. How do you see things playing out?

The bond market appears to be pricing in 10 to 12 rate hikes over the next couple of years, though I doubt we'll get that many. Bank loan activity is a signal for growth in the economy and loan-to-deposit ratios are hovering near all-time lows. I'm more concerned with how quickly rates increase. There are 50-bps hikes priced into each of the next two meetings, and it will be interesting to see what that does to banks' balance sheets.

What's going to be the impact on deposit betas as rates rise? And does the size of the bank matter?

I think it does. Big banks rely less on spread, so I doubt they'll have to change deposit rates much. But smaller banks do rely — heavily — on spread business. Those institutions will probably feel some pressure over the next six to 12 months. But even they have some time.

That said, I don't believe cost of funds is driven by the Fed. It's driven by the LTD ratios of a bank's main competitors. It's all supply and demand. But right now, banks are artificially large, so regardless of what their competitors do, they might just let their balance sheets shrink to a more normal size, with better capital levels.

How sticky will all this liquidity be?

It's hard to say. The deposit landscape has changed, so we can't make assumptions based on historical trends. But depositors are starting to realize that they're losing money by letting it sit in a bank while inflation spikes and rates head north. They want to know what they can earn from their banks. I'm actually less concerned with depositors running out the door than I am with them shifting from non-interest DDAs into some form of money market account.

If deposits leave, should banks focus on increasing their deposit base or locking in wholesale funding?

Both. I'm a huge advocate of wholesale funding as a tool to manage interest rate risk, grow earnings, and invest back into the institution. It should be in every bank's playbook. It also enables banks to determine which part of the curve to be on without bothering their customers.

In a highly unpredictable world, it's something banks can control relatively easily?

Yes, and that uncertainty is why I'm also a little bit bullish on buying bonds right now. There could be a ton of rate hikes over the next 24 months, and beyond that, the yield curve is basically flat. A lot of bankers aren't concerned about higher rates in two years. They're actually concerned that rates could drop, and we have a recession. I'd argue that banks should be buying bonds. Earning a little less now and taking on a little more interest rate risk might be a tough sell to their boards, but when you think about the lack of loan demand, it makes sense.

What other advice would you give banks?

It's all about weaponizing your balance sheet. Banks should focus on answering three questions: What hurts? What helps? And what are we going to do about it? That's the best way to fight market volatility.

ALCO members should start by understanding which parts of the yield curve matter most to their institutions. This will enable them to reduce exposure where necessary and design strategies around smaller moves in the shape of the curve that are more actionable. They should already know what they're going to do with every 10-to-15 basis-point flatter or steeper, so when the time comes, all they have to do is execute. They don't need to write a memo or assemble a special committee to watch rates. Too many banks are reactive — they wait for rates to go higher, then add insurance to hedge against rising rates.

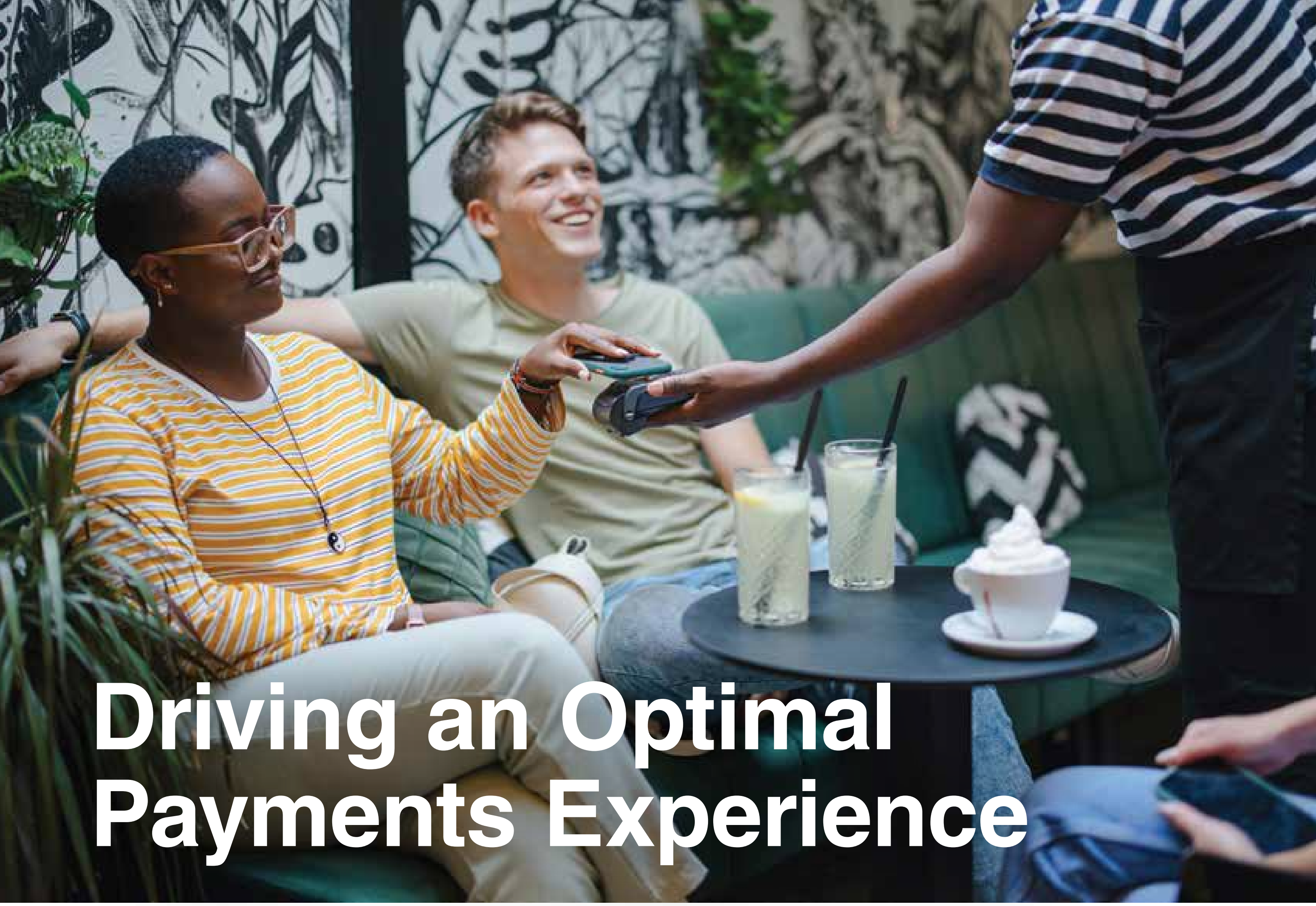
> It's all about weaponizing your balance sheet. Banks should focus on answering three questions: What hurts? What helps? And what are we going to do about it? That's the best way to fight market volatility.

There are a lot of behaviors banks can stop, too: They should stop treating all risk as interest rate risk (yield curve risk is far more important), stop treating ALCO meetings like a dentist appointment to get through as quickly and painlessly as possible, stop looking backward and start looking forward.

What are the best- and worst-case scenarios for the industry?

Best-case scenario is loan demand picking up. Some spread widening in lending would be great, because banks have time before deposit costs go up. Banks could make a lot of money with loan growth and higher interest rates on the short end of the curve.

Worst-case scenario is the Fed hikes rates a bunch of times, LTD ratios stay where they are, and we get stuck in a world of stagflation, where things look a lot like they have over the past ten years. I'm concerned that we've seen the belly of the yield curve up over 100 basis points in a short period, and most banks don't have the loan demand to capture that full interest rate move. So, we're likely going to have a slight correction on credit. In the meantime, there are no more PPP fees coming through the door. Add it all up and it could be a tough year — even with the rate increases.



Driving an Optimal Payments Experience

By Brian Scott
Chief Growth Officer
Primax

When it comes to payments processing providers, banks don't always know they have options outside their core processor. There are many innovative payments fintech providers that can offer more capabilities than a core processor – which means banks could be missing out on available features and benefits that could give them an edge with their cardholders.

By partnering with providers who can offer a full suite of robust features – not just core processing services – the cardholder experience could improve significantly, driving further retention of your customers seeking these capabilities with their payments experience. This will also help to ensure you're getting the most value for your investment.

When considering the best payments processor for your bank, it's important to look for top-of-the-line payments processing – as well as these seven capabilities that can help drive an optimal experience for your customers.

1. **Integration enhances the user experience.** An innovative partner will be able to collaborate with your IT team to ensure a seamless cardholder experience. Partners should look to build a relationship with core system providers to eliminate inefficiencies and streamline support services. Additionally, coordinating with technology partners, digital platform development teams and APIs will help provide the driving force for innovative changes, ultimately lowering operational costs and enhancing customer experiences.

2. **Digital capabilities with user-centric framework.** When it comes to mobile and online banking platforms, users want and expect personalization, flexibility and comprehensive card management tools. Features like alerts and controls, digital issuance,

> When it comes to mobile and online banking platforms, users want and expect personalization, flexibility and comprehensive card management tools.

card credentials access and mobile wallet support can make a payments provider stand out. Users expect to be able to access their information through their channel of choice, so cross-platform integration, parity between experiences and a robust administrative tool are imperative to provide users the seamless experience they now demand.

3. **Increased automation to improve efficiency.** Accessing customer debit and credit card account data doesn't have to be a headache for your front-line staff. Look for a partner who can offer single-point, real-time access to your cardholder data, minimizing the need for staff to reference multiple systems and data repositories. This lowers service costs, increases back-office efficiency and raises cardholder satisfaction.

4. **Essential fraud and risk mitigation capabilities.** Balancing fraud management and a positive customer experience can be challenging for financial institutions, especially when the tactics being used by hackers are growing increasingly more sophisticated every day. As fraud attempts become more refined, so must risk mitigation tactics. Partnering with a payments processor that can offer enhanced fraud services and provide customized risk management strategies can help ensure your customers and your bank stay safe and protected. Innovative payments providers have found ways to integrate data from every transaction, interaction and event to predict and prevent customer fraud while expertly recovering any losses.

5. **Data and analytics offer actionable insights.** Data management requires more than just collecting information on cardholders. A robust data and analytics program requires analysis and interpretation of your data to better understand customer behavior and identify actionable insights, delivering highly-personalized experiences and comprehensive data protection. Detailed reporting can help provide a deeper understanding of customer behavior and identify growth opportunities, while predictive analytics can provide best-in-class scoring models that uncover key insights to guide precise and informed decisions.

6. **Contact center with a multi-channel approach.** Your bank's contact center is often the hub of your communications, support services and fraud protection services. Having a partner to help you deliver the highest level of service through your contact center can improve customer experiences, prevent fraud losses and increase your revenue. Fintech payments partners can integrate with your core processor to create a seamless extension of your bank's unique brand for both card support and account services across multiple channels and platforms.

7. **Ability to elevate your business growth potential.** The hallmark of a great partner is not just in its ability to provide exceptional products and services, but also to be a trusted advisor, ready to help you elevate your business growth potential. This can be done by leveraging resources such as data scientists to help you understand and use cardholder data, marketing experts to help execute growth marketing campaigns and strategic consultants to help with product optimization and to identify areas of high growth potential, such as commercial card portfolios.

With banks now realizing that it's no longer enough to only provide the bare minimum in payments processing, finding a partner who can offer a comprehensive suite of products and solutions has never been more important. Ensuring that you're giving your customers the best possible user experience – while driving full-service solutions – will ultimately help you retain your existing customer base while paving the way for future growth.

Brian Scott partners with industry leaders in payments and community financial institutions to create competitive payments programs, helping financial institutions position themselves competitively in their own communities and maintain profitability throughout their payments programs. Brian spent 23 years in the highly competitive consumer payments marketplace and is a recognized leader in payments solutions and innovative technologies. He is a frequent speaker on the future of payments, new payments trends, mobile banking, alternative payments, and how new payments technologies will transform the current banking space.

Mitigating CRE Risk in a Volatile Market

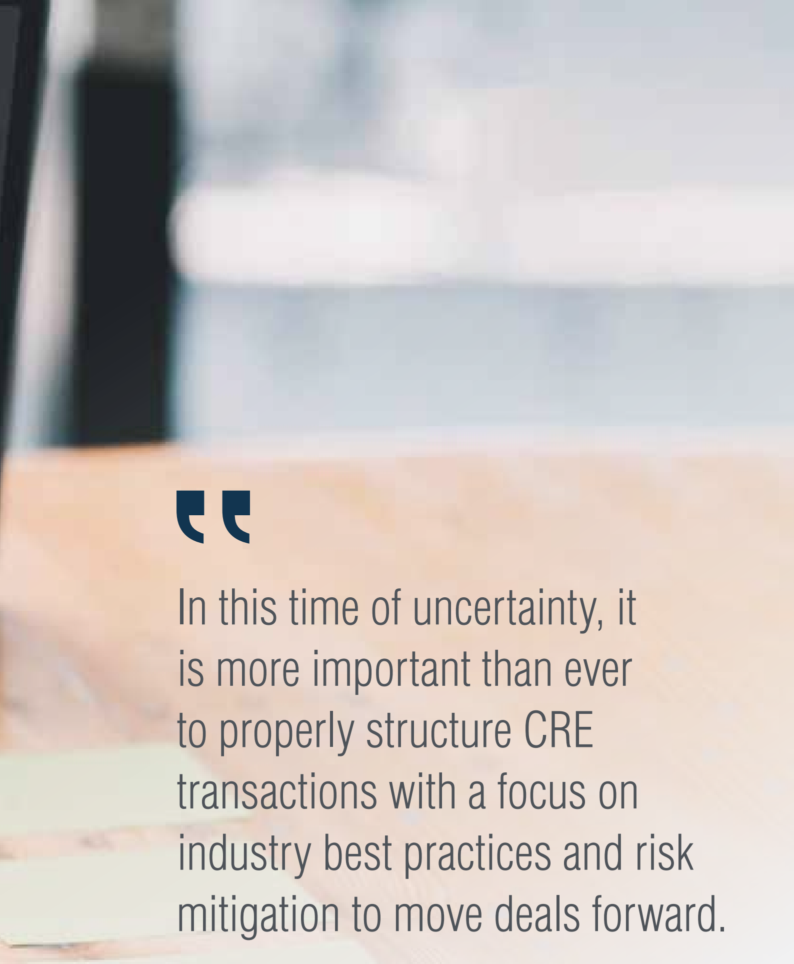
By Russ Mabry
Senior Consultant
Moran Construction Consultants

With the ever-growing concern of rising construction costs, it is imperative to understand what's happening in the market, the impact it can have on your next deal and how to mitigate the risk. According to a recent analysis by the Associated General Contractors of America, construction material costs have increased by 20% year-over-year from January 2021 to January 2022. This is the largest recorded material cost increase since 1970. Due to recent geopolitical events, persistent demand and the continuing supply chain issues, the trend of inflation and rising construction costs are projected to continue for the foreseeable future. In this time of uncertainty, it is more important than ever to properly structure CRE transactions with a focus on industry best practices and risk mitigation to move deals forward.

Rising Costs & Price Volatility

Since the start of the pandemic, a multitude of factors have been attributed to the material cost increases the industry is experiencing today. To better understand how to identify and mitigate this risk, let's look at some of the main contributing factors:

- **Inflation:** Costs for construction materials, like most other goods today, continue to rise. Take lumber for example: over the past year, lumber experienced record highs followed by sharp drops; however,



In this time of uncertainty, it is more important than ever to properly structure CRE transactions with a focus on industry best practices and risk mitigation to move deals forward.

costs have climbed back up 40% from pre-pandemic levels. With demand remaining strong, suppliers continue to hold the upper hand.

- **Supply Chain Disruption:** Material availability and delivery lead times continue to challenge project teams. From PVC to roofing material, steel, appliances and even paint, these disruptions continue to persist. With most facilities having to shut down or slow down at some point during the pandemic, the demand never wavered. This in turn led to supply not being able to keep up with demand, creating a feeding frenzy for materials, ultimately driving costs higher.

- **Labor Shortage:** Labor also plays a large role in the volatility of the market. While labor concerns were already plaguing the construction industry, the pandemic compounded the issue. Project slowdowns, concerns over health risks and government subsidies drove the workforce to stay home in lieu of reporting to work during the pandemic. With fewer workers available to put work in place, labor costs began to rise. The construction industry is experiencing a major shortage of skilled labor. With 20% of the construction workforce over the age of 55 and the number of workers between the ages of 25-54 decreasing by 8% over the past decade, there are concerns over how the age of the workforce will affect the industry long term.

Mitigating Risk

While the market environment is rife with volatility, the housing crunch and historically low interest rates through the bulk of the pandemic kept the demand for new project starts at an all-time high. This seeming paradox currently has credit departments tightening requirements and pushing prospective borrowers to take on the risk of rising costs post-closing. To keep deals moving forward in these uncertain times, risk mitigation is of heightened importance. Mitigating this risk, much of which is unknown, requires diligent underwriting, learning from the mistakes of others and implementation of sound industry practices. Below you will find a two-part recommendation for assistance in identifying and ultimately mitigating risk currently involved in CRE transactions.

The two-part solution refers to identifying and mitigating risk pre-closing (loan underwriting) as well as tracking the risk post-closing (loan servicing).

Pre-Closing

Identifying risk and implementing mitigating efforts during the underwriting phase are nothing new to the CRE world. What has changed over the last 18 to 24 months is the focus of the due diligence review and underwriting process. Below you will find a current list of what to focus on and industry best practices that have proven to be successful in the face of extreme uncertainty:

- **Contractor/Project Team Qualifications:** Contractor selection can make or break any CRE project. In today's market, selecting the right contractor is imperative to a successful outcome. Pre-pandemic it was customary to review the corporate resumes and financial statements of contractors. In today's environment, we must take the analysis one step further. Not only is it good practice to underwrite the corporate entity, but it is also extremely important to identify and vet the individuals who are proposed to manage and supervise the project in the field. This is accomplished by reviewing resumes and interviewing those who will be tasked with the daily operations on site. This step is recommended to ensure the proposed field team has adequate experience with similar projects and understands the risk that exists in today's market.

Continued on page 24

“

With 20% of the construction workforce over the age of 55 and the number of workers between the ages of 25-54 decreasing by 8% over the past decade, there are concerns over how the age of the workforce will affect the industry long term.

Continued from page 23

- **Contract Language:** When dealing with unprecedented market volatility, being proactive is the best solution. Current industry practices are trending toward a fair and equitable share of cost increases that are out of the control of project teams. Inserting language into construction contracts that dictates what happens in the event of an unexpected cost increase and who will be responsible for the cost is of utmost importance. This language should also include a cost threshold (i.e., dollar amount or percentage of contract value) that must be reached prior to an equitable sharing of the risk. Not only should the contract include explicit language regarding cost increases, but it should also address potential time increases as well as provide a clear definition of force majeure.

- **Thorough Review of the Budget:** After review and approval of the contract terms and conditions, the next step is to thoroughly review the project budget. Gone are the days of using historical costs as a basis for budgeting or creating guaranteed maximum contracts. Construction costs are evolving so rapidly that the historical cost method is no longer accurate. The budget should be comprised of true and current (within 30 days) market pricing, backed up with supporting documentation from subcontractors and vendors. Overall project budgets should be vetted against recently completed projects of similar size, scope and location. In addition to the standard evaluation of the overall cost, the budget should be analyzed on a line-item basis, comparing itemized work scopes to similar projects in a specific market. Due to the fluidity of the market, this additional layer of cost evaluation often requires the assistance of a third-party cost consultant.

- **Procurement Process:** Gaining a deep understanding of the project team's procurement process has recently taken on greater importance during the underwriting phase. Understanding the intended purchasing strategy sheds light on multiple aspects of the project including the following: the number of outstanding subcontracts, the potential for stored materials, the required material deposits and even anticipated material lead times. To gain this understanding conversations must be held with the project team regarding their intended timing and methods for project purchasing and relationship with the market. It is important to note – as a lender, it is wise not to dictate the procurement process, as this would encroach on a borrower's means and methods, which can lead to placing the undue risk on a lender.

- **Tying Loan Terms & Contract Terms Together:** The final and most important step is to leverage the loan terms in concert with the construction contract. As simple as this sounds, this final step seems to be the one most often missed or overlooked prior to closing.

Post-Closing

Once the loan is closed, it is not safe to assume that a well-structured deal will simply run itself and stay out of trouble. Monitoring the progress of the project is equally important to track project metrics and report pending or looming issues. For without timely information, the lenders run the risk of receiving untimely "surprises" that can potentially derail a project or prevent the lender from making timely business decisions.

The second piece of the risk mitigation solution includes monthly monitoring of each CRE loan. Monitoring includes employing a third-party consultant to visit each site monthly for reporting on the following:

- **Project Cost:** Is the project tracking on the original budget? Are proposed cost changes warranted and in line with the contract language? Will any potential cost increases require a loan increase? Will the borrower be required to obtain additional funding?

- **Project Time:** Is the project tracking on the original project schedule? Are proposed time extensions warranted and in line with the contract language? Will any potential time extensions require a loan increase or extension?

- **Project Quality:** Is the project being completed in accordance with the project documents? Will potential cost increases require scope changes or reductions to keep the project within budget?

Having "boots on the ground" representing the lender's best interest is paramount in understanding where each deal is in the process and where the measured risk lies.

Moran Construction Consultants is a nationally recognized construction consulting firm with services ranging from initial due diligence assessments to construction loan monitoring to owner's representation. With more than 250 years of combined experience, they mitigate the risk of investments for lenders, syndicators, investors, and owners while adding value to the project team.

Colorado Banker

140 East 19th Avenue
Suite 400
Denver, Colorado 80203

PRSRT STD
U.S. POSTAGE
PAID
SALT LAKE CITY, UT
PERMIT NO. 508

This magazine is designed and published by The newsLINK Group, LLC | 1.855.747.4003