theBHCA.org — Fall 2023

# Bank Owner

Bank Holding Company Association Magazine


## *M&A Success Strategies*

***Plan to attend Oct. 2-3 Fall Seminar***

**You've Implemented CECL, Now What?**

**Investigating Fraud – 72 Hours to Get It Right**

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# Bank Owner

Fall 2023

The Bank Holding Company Association exists to provide education and business connections critical to the vitality of bank holding companies.

Founded in 1981, the BHCA welcomes Members from around the country. Holding companies of all sizes from throughout the Midwest make up a majority of the current membership. Companies that serve bank owners, their holding companies and banks, are welcomed as Associate Members.

The *Bank Owner* magazine is the quarterly publication of the BHCA. The magazine is your best source for BHCA information, including upcoming events. Members receive the magazine in the mail and have access to an online version at theBHCA.org. Managing Director Tom Bengtson serves as editor. Contact him at (952) 835-2248 or email us at Tom@thebhca.org.

**ON THE COVER:**
Presenters share thoughts during a panel discussion at a recent BHCA seminar.


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BHCA
BANK HOLDING COMPANY ASSOCIATION

**www.theBHCA.org**



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## New to BHCA

**The Bank Holding Company Association is pleased to welcome two new Associate Members:**

**The CorePoint**
Neil Stanley, President
Omaha, Neb.

**FI MarketScan Advisors**
Greg Gould, co-founder
David Jones, co-founder
Tony Baumgardt, partner


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# BHCA worked through the Summer to deliver on the value of your membership

By Denise Bunbury
*State Bankshares, Inc. (Bell Bank)*
*Eau Claire, Wis.*

While Summer is a great time to take a vacation, it is not a time of idleness at the Bank Holding Company Association. All Summer long, we have been working to prepare our Fall Seminar, as well as deliver a couple of important documents to you.

If it hasn't already arrived in your mail, members will soon receive the annual membership directory. This is an invaluable resource designed to help you connect with other members. Sometimes you want to follow up with someone you met at one of our seminars, and didn't get their business card. The directory provides a phone number, mailing address and email address for nearly every member. We always say networking is one of the greatest benefits of BHCA membership, and we know networking can happen in person at one of our events, or over the phone or via email, all year long.

I also like the membership directory because it serves as a living document that is preserving the history of the association with respect to our past officers and board members. We list them all, going back to our founding in 1981. We will keep doing that because it is one way that we honor the contributions that many people have made to the success of the BHCA over the past four decades.

Also this month, we have published our annual national directory of bank holding companies across the country, showing each of their bank subsidiaries and a few key facts about each. This is the fifth year we have published the directory, and I believe it is a real service to the industry. The directories are available now under the "resources" tab at our website, www.theBHCA.org. The holding company remains an important legal structure for bankers to make the most of their bank charters, and this directory shows that most banks in the country remain part of a holding company. Most of them are located in the midwest and center part of the country, where the majority of our BHCA members reside.

As we prepare to enter autumn, I am very excited about the BHCA Fall Seminar, which has the theme "M&A Success Strategies." You can read about the seminar elsewhere in this magazine, but let me communicate here my enthusiasm for this event. We all know how important strategic planning is. Whether you look out two, three, five or even more years, you and your leadership team most likely have thoughts about the future of your organization. Whether you plan to continue to lead your organization through the coming decade or you envision others taking over, this seminar will give you much to think about in terms of ownership options. Even though you may be years away from doing a deal, I think it is incumbent upon almost all owners to understand the value of their franchise, how deals work, what kinds of deals make the most sense given the circumstances, and something about realistic shareholder expectations. Our Fall Seminar has been addressing these kinds of issues since 2017 when we conducted our first M&A seminar.

As you know, we have some of the most respected and experienced community bank M&A experts in our BHCA associate membership, and we are delighted to give them a platform to share their expertise and knowledge with all of you in the efficient and convenient format of our seminar. Please register now on our website. Plan to bring others from your organization, and encourage board members to attend. Everything presented at the Fall Seminar will be relevant to engaged community bank board members.

One more thing. The BHCA board is making an effort to reach out to holding company officers at institutions that currently are not members. We think we have a great thing going

**President's Observations,** *Continued on page 14*

# Changing industry landscape gives bankers, investors pause as calls for increased capital mount

By Tom Bengtson
*BHCA Managing Director*

People used to talk about the banking industry as a "barbell," meaning that if you lined up all the banks from largest to smallest you'd have a lot of banks on the large end of the spectrum, fewer banks in the center, and another sizable group of banks on the smaller end. I am not sure that we have a barbell today.

Out of approximately 3,700 bank holding companies across the country today, 2,250 of them have $500 million or less in assets. Another 630 holding companies have assets ranging between $500 million and $1 billion. That puts about 2,900 holding companies on the smaller end of the spectrum. Of the remaining holding companies, most have assets ranging from $1 billion to $10 billion; 110 have assets ranging from $10 billion to $100 billion, and 35 have more than $100 billion. Of those 35, only a third of them automatically qualify under current law as systemically important because they have more than $250 billion in assets.

Keep in mind that while the number of banks is highly skewed toward smaller institutions, assets are highly skewed toward the largest institutions with the vast majority of industry assets controlled by the six bank holding companies with more than $1 trillion in assets each.

Although deal volume has been modest this year with the number of merger and acquisition transactions down from recent years, consolidation has reduced the number of banks in the smaller ranks, and moved banks more toward the larger bank sector.

Lawmakers, regulators, policymakers and pundits are mostly focused on institutions in the $10 billion to $250 billion asset space, a total of about 132 bank holding companies. The three high-profile bank failures earlier this year shined a spotlight on these banks that some folks call "regional" banks or "mid-size" banks. They seem like big institutions to me, although in the barbell analogy, they would be the narrow bar in the middle.

Among those focusing on those mid-size banks is Federal Reserve Board Governor Michael Barr, the vice chair for supervision. On July 10, he tipped his hand on rules in development that will help banks assess lending risks. The *Wall Street Journal* said he wants to end "the practice of relying on banks' own individual estimates when it comes to lending risks, warning that the firms' internal models 'suffer from deficiencies.'"

His ideas include changing the way banks account for unrealized losses in securities they hold. In essence, he would require the largest banks to hold an additional 2 percent capital.

The rules are expected to apply to all banks that have more than $100 billion in assets. The Independent Community Bankers of America applauded his comments, although President and CEO Rebeca Romero Rainey added "we caution regulators to ensure new capital standards have no trickle-down effect on institutions below $100 billion in assets, including community banks."

Higher capital requirements are not the answer, commented Rob Nichols, president and CEO of the American Bankers Association. "We are disappointed that he remains determined to push forward new bank capital requirements despite strong evidence that the U.S. banking system is already well capitalized as regulators have concluded. ... Higher capital requirements come at a cost to the economy, and regulators have other existing regulatory tools to manage risks including those that led to the recent bank failures."

Separately, Minneapolis Federal Reserve Bank President Neel Kashkari published comments on July 12 in which he suggested regulators prevent struggling holding companies from paying dividends in times of rising inflation. Pointing out the stabilizing effect of additional capital in the banking system during periods of inflation, he said banks are unlikely to reduce dividend payouts on their own so regulators should step in.

From a regulator's point of view, additional capital means more industry strength, but from an investor's point of view tying up more capital means less return on investment. The tension between the two points of view is important, because economic policymakers typically value stability in the banking industry but investors may take their investment dollars elsewhere if the restrictions around banks diminish the industry's competitiveness with other investment options.

This isn't the first time Kashkari and the Minneapolis Federal Reserve Bank have advocated for higher levels of bank capital. Back in 2016, shortly after he came to the Minneapolis Fed, Kashkari convened a series of meetings to search for solutions to the too-big-to-fail problem. With some of the best economic minds in the country participating, including former Federal Reserve Board Chair Ben Bernanke, the Minneapolis Fed Bank produced the "Minneapolis Plan," which proposed banks reduce their risk by substantially increasing their capital. The plan never gained traction, perhaps partially because of investor resistance to the proposed solution.

On the small bank end of the spectrum, there is a positive development worthy of the spotlight. A group of Republican

**Down to Business,** *Continued on page 14*

# Jeffrey Schmid named president/CEO of the Federal Reserve Bank of Kansas City

Jeffrey Schmid

Jeffrey R. Schmid, president and chief executive officer of the Southwestern Graduate School of Banking Foundation at Southern Methodist University's Cox School of Business, has been appointed president and CEO of the Federal Reserve Bank of Kansas City, beginning August 21, 2023.

Schmid has more than 40 years of banking and regulatory experience, including positions at the Federal Deposit Insurance Corp., and in leading the establishment of Mutual of Omaha Bank, where he served as chairman and CEO. He is a native of Nebraska.

Schmid succeeds Esther L. George, who retired from the Federal Reserve Bank of Kansas City on Jan. 31, 2023, as required by mandatory Federal Reserve retirement rules for presidents.

"We are excited to welcome Jeff back to the Tenth District as the Kansas City Fed's next leader," said María Griego-Raby, president and principal of Contract Associates in Albuquerque, N.M., who, as deputy chair of the bank's board of directors, led the bank's search committee. "Jeff's perspective as a native Nebraskan, his broad experience in banking, and his deep roots in our region will be an incredible asset to the Federal Reserve, both as a leader of the organization and in his role as a monetary policymaker."

Schmid began his career in 1981 as a field examiner based in the FDIC's Kansas City, Mo., office, where he spent eight years examining banking organizations and supported the oversight of a significant portfolio of troubled banks. In 1989, he was named president of American National Bank in Omaha, where he served until 2007 as the community bank grew from $500 million to $1.5 billion in assets.

From 2007 to 2019, Schmid served as the chairman and CEO of Mutual of Omaha Bank, leading the formation of the institution, which grew to a workforce of nearly 2,000. After the bank was sold to CIT group in 2019, he became CEO of family-owned Susser Bank in Dallas. He then joined the Southwestern Graduate School of Banking Foundation at SMU as its president and CEO in 2021. The Foundation, housed at SMU's Edwin L. Cox School of Business, has provided bank management programs, education and training for thousands of financial services professionals and government regulators, as well as education programs for commercial bank directors.

Schmid has a Bachelor of Science degree in business administration from the University of Nebraska-Lincoln and is a graduate of the Southwestern Graduate School of Banking. He serves on the boards of Operation HOPE in Atlanta, and Avenue Scholars in Omaha, Neb., and is on the advisory board of the Cox School of Business at SMU.

"I am honored to be selected to serve the Tenth District in this role and for the opportunity to lead the Kansas City Fed's talented workforce as it carries out its important public mission," Schmid said. "It is a privilege to represent this region and to be able to build upon the long tradition of service that the bank is well known for." ■

# St. Louis Fed Bank president/CEO resigns

Federal Reserve Bank of St. Louis President and CEO James Bullard has resigned to become the first dean of Purdue University's Mitchell E. Daniels, Jr., School of Business.

Though Bullard's resignation was effective July 13, he remained available to the bank's leadership in an advisory capacity until August 14.

The St. Louis Fed board of directors confirmed Kathleen O'Neill Paese as interim president and CEO while a national search ensues for Bullard's replacement. O'Neill Paese most recently served as St. Louis Fed first vice president and chief operating officer.

"I am honored and excited to step into the role," O'Neill Paese said. "I look forward to doing the important work of supporting monetary policy and economic development in the Eighth District."

St. Louis Fed Board Chair Jim McKelvey and Bank Deputy Chair Carolyn Chism Hardy will lead a search committee of six directors who are unaffiliated with regulated banks and financial institutions. The committee expects to retain a national executive search firm.

James Bullard

Bullard joined the St. Louis Fed in 1990 as an economist in the research division. Bullard, who was named president and CEO on April 1, 2008, has called for the timing of monetary policy decisions to be driven by economic data rather than by a set schedule. During the Great Recession, Bullard called for an explicit inflation target, which the FOMC later adopted at 2 percent.

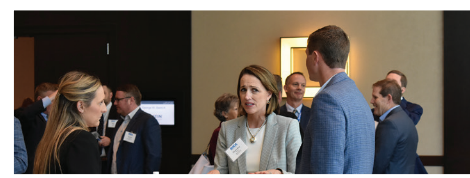
"The Bank is well-positioned for ongoing success and impact," Bullard said. "I am also grateful to have worked alongside such dedicated and inspiring colleagues across the Federal Reserve System and for the opportunity to have worked for the many outstanding directors who have served on the St. Louis Fed board. It's been an honor to serve this great institution." ■

BHCA

FALL SEMINAR | OCT. 2-3

# M&A SUCCESS STRATEGIES

WESTIN GALLERIA HOTEL, EDINA, MINN.



## NOW IS THE TIME TO PLAN FOR M&A SUCCESS

Planning is a key part of any important success strategy. So while the current environment for mergers and acquisitions in the community banking arena is generally quiet, it is a great time to assess the industry landscape, consider your own organization's aspirations, and plan for success when the time is right. M&A Success Strategies brings together the experts and experienced bankers to help you set your course for the future.

We'll look at everything from the big picture to the smallest details during this informative two-day event hosted by the Bank Holding Company Association at the luxurious Westin Galleria Hotel in Edina, Minn. We've assembled some of the country's most experienced community bank M&A experts to share insights into market trends, capital raising, effective dealmaking, non-traditional buyers, tax implications, investment strategies and even the impact of artificial intelligence. Many of our sessions include community bankers from the Upper Midwest who will share their first-hand experiences.

In a special presentation designed to interest almost anyone involved in business is our Tuesday luncheon session where economist, best selling author, and former White House director of economic policy Todd Buchholz will offer a global geopolitical economic assessment, including thoughts on demographic, technical and market trends. He will look at the warning signs and potential opportunities coming out of the current environment for interest rates, the labor market, inflation and other factors that may affect your deal, whether you have plans for an M&A transaction in the next few months or the next several years.

The seminar agenda includes seven general session presentations and three breakout sessions. Of course, some of the most informative people at the seminar will be your fellow attendees. We have left lots of time for networking during the event reception, breaks and three meals. We start midday Monday, Oct. 2 and conclude after lunch on Tuesday, Oct. 3. It's a tried-and-true, economically-priced compact event formula that could prove to be the best seminar you attend all year.

Register early to secure your place. Everyone who registers before Sept. 1 will be entered into a drawing for a free full registration at a 2024 BHCA seminar. We'll conduct the drawing at the seminar on Oct. 3. This event is perfect for bank owners, holding company senior officers, directors and bank senior managers. Bring several people from your organization and share impressions at your next board meeting or strategic planning session!

AGENDA

# MONDAY 10/2

*Noon to 1:00 pm* | **Luncheon Served**

*1:10 to 2:00 pm* | **The Path Forward for Community Banking and M&A**, Curtis Carpenter, *Hovde Financial Group*

This fast-paced, data-rich review of the changing economic landscape and how it is impacting bank values and performance will look forward to what is next for community banking and how M&A pricing and deal structures are evolving.

*2:00 to 2:50 pm* | **A Spoon Full of Capital Helps the Regulatory Scrutiny Go Down**, Craig Mueller and David Stieber, *both of Oak Ridge Financial*

Two community bank M&A veterans sit down with **Dean Heinzmann** of Fortress Bank, Peoria, Ill, and **Rick Parks** of First National Bank of Waterloo, Ill., to discuss reasons to raise capital and how to put that capital to work. The quartet will share first-hand thoughts on using capital to make acquisitions, grow organically, and to manage AOCI. Other uses? This panel will cover the gamut.

*2:50 to 3:20 pm* | **Break**

*3:20 to 4:10 pm* | **The New Purchase Agreement**
Scott Coleman and Sarah Dannecker *of Ballard Spahr*

Representations, warranties, operating covenants and indemnifications have always been an important part of a transaction, but recent economic and regulatory developments have changed what can be expected in a purchase agreement. Scott Coleman and Sarah Dannecker team to present examples from the perspective of the buyer and the seller that are more frequently finding their way into the fine print. These include provisions covering liquidity and other balance sheet hot spots.

*4:10 to 5:00 pm* | **Significant Legal Issues in Bank M&A Deals: Case Studies**, Tony Moch, Amber Kraemer, Tom Walker and Trina Sjoberg, *all of Winthrop & Weinstine*

Banks spend significant time on employment, compensation, benefits and staffing matters that arise in any M&A transaction; our experts will conduct a bank sale case study with a banker to discuss how these issues were handled in a transaction. In another case to be considered, we'll look at bank facilities and real property that were part of a bank transaction. Bank CEO **Marc Campbell** of Luminate Bank will share his experiences as well.

*5:00 to 6:30 pm* | **Reception** | *Dinner on your own*

# TUESDAY 10/3

*7:30 to 8:45 am* | **Buffet Breakfast**

*8:45 to 9:35 am* | **Avoid Unintended Tax Consequences of a Deal: DETAILS MATTER!** Paul Sirek and Aric Radmacher, *both of Eide Bailly*

There are several unique tax provisions in play when planning and closing a bank acquisition. Careful planning is not only required with the initial structure of the deal, but managing potential tax risks involved with deductibility of compensation and other acquisition-related expenses should be carefully planned to optimize tax benefits. Missing a seemingly small detail can result in substantial unintended tax consequences on a deal.

*9:35 to 10:25 am* | **Why a Non-Traditional Buyer May Be Interested in Your Bank,** Joseph Ceithaml, *of Barack Ferrazzano's Financial Institutions Group*

We have seen a surge in the number of sales of smaller banks to non-traditional buyers, primarily financial technology companies and investor groups without an existing bank. Non-traditional buyers are typically willing to pay a substantially higher premium than banks and including them in an auction process may generate pricing competition, resulting in a higher price for the seller even if it decides to sell to another bank.

*10:25 to 11:00 am* | **Break**

*11:00 to 11:45* | **Breakout sessions**, *choose one session:*

**Not All Earnings Are Created Equal**
Austin Nicholas, *Vice President*
*Investment Banking, Performance Trust Capital Partners*

While earnings drive value over the long term, this session takes into consideration the riskiness and sustainability of those earnings. See how the right framework can illuminate the fundamental, sustainable value of your bank's earnings stream and how a multi-scenario decision-making process can help avoid decisions where the risk is not worth the near-term, single-scenario return.

**Data May Pave the Way to Earnings Boost**, *Presented by RSM US*

A community bank's position in the M&A arena, as either a buyer or seller, is enhanced by strong earnings. Access to data can give a bank an opportunity to increase wallet share and meaningfully boost its earnings. Information however can be hard to find or often is insufficient for developing effective strategy. This session will offer a demo of the RSM FI Insights platform. The solution provides a dashboard that allows banks to develop a deeper understanding of customer banking activities and earn more business.

**How will Artificial Intelligence change community banking?** Katie Quilligan, *BankTech Ventures*

AI offers community banks tremendous opportunities for increasing efficiency and improving processes. Learn what some banks are already doing, and what is likely to become commonplace in the next few years.

*Noon to 12:45 pm* | **Lunch**

*12:50 to 1:45 pm* | **Prosperity Ahead – or not?**
Todd Buchholz, *economist, best selling author, former White House director of economic policy*

Discover how demographics, technology, and globalization are reshaping the economy and our future; Pinpoint the signs of stock market rallies, and the warning signs of slumps, and identify the political pressures on trade, debt, and interest rates from the U.S. to the E.U. to China, in this event-closing Keynote address.

*1:50 pm* | *Adjourn*

**LOCATION**

**The Westin Edina Galleria**
3201 Galleria
Edina, MN 55435

To make your reservations, please contact the hotel directly at 952-567-5000

Book your room today to lock in our special rate! The deadline to book at our special rate is **Friday, September 22th.**

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Company Name__________________________________

Address______________________________________

City________________ State____________ Zip__________

Phone_________________ Email____________________

Guest Name(s) ___________________________________

*Please indicate dietary restrictions here:*____________________

| FULL SEMINAR: | | | Number | Amount |
|---|---|---|---|---|
| BHCA Member | | $550 | ______ | ______ |
| Non-Member | | $800 | ______ | ______ |

| OPTIONS: | | | Number | Amount |
|---|---|---|---|---|
| Monday Only (Oct. 2) | *Members* | $250 | ______ | ______ |
| | *Non-Members* | $375 | ______ | ______ |
| Tuesday Only (Oct. 3) | *Members* | $350 | ______ | ______ |
| | *Non-Members* | $450 | ______ | ______ |
| Tuesday Evening Dinner and Show | | $135 | ______ | ______ |

**TOTAL AMOUNT ENCLOSED:** $________________

*Mail Registration to:*
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250 Prairie Center Dr., Ste. 300, Eden Prairie, MN 55344
Or Register online at **www.theBHCA.org**. Need more info? Call **952-835-2248**

The cost of the meals, entertainment and breaks included in the registration fee for this event are estimates at $75 for Monday, and $125 for Tuesday. This information is provided for your tax records in keeping with IRS deductibility provisions. By registering, you authorize the BHCA to use your image for promotional purposes. Cancellation Policy: Due to commitments and expenses, all cancellations after September 15 will by subject to $75 processing fee. We regret that no refunds will be given after Sept. 20, 2023; however, substitutes are welcome anytime. The BHCA assumes no liability for any nonrefundable travel, hotel or related expenses incurred by registrants. Cancellations or substitutions must be made in writing to Tom@theBHCA.org.

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# THE RISE OF GENERATIVE AI IN THE BANKING SECTOR

*By Billy Collins*

The banking industry is on the cusp of a technological revolution, with generative artificial intelligence (AI) poised to play a pivotal role.

If you're in the camp that believes generative AI is being too hyped up, consider this: Only 7 percent of banking executives said they had no plans to adopt generative AI, a figure that is down from 50 percent earlier this year.

Generative AI has the potential to revolutionize consumer and commercial banking in both big and small ways.

AI has already been helping the financial institutions industry by automating tedious tasks, creating more effective solutions based on existing data, improving productivity and enhancing customer service and satisfaction.

Generative AI exists, however, to fill a specific niche untouched by the AI tools many leaders may already be familiar with today.

Generative AI tools and use cases are increasing at a dramatic rate as established businesses and startups alike try to stake their claim in the AI gold rush.

True adoption of generative AI tools by financial institutions, however, has been slow.

Only about 17 percent of banking executives said they were in the process of implementing some generative AI use cases in April 2023 (up from about 7 percent earlier in the year).

But the demand and significance of generative AI has increased as more customers access their accounts and conduct business on their smartphones or computers.

Now, AI technologies, such as machine learning (ML), have already found applications in the banking industry.

ML algorithms automate tasks, such as fraud detection, credit scoring and customer service through automated responses.

Generative AI, however, takes automation a step further by enabling computers to generate new content and make intelligent decisions based on patterns and trends identified in vast volumes of data.

Generative AI offers several key benefits that make it well suited for the banking industry:

**Personalization** – Generative AI can analyze vast amounts of consumer data, such as purchase history and browsing behavior, to identify trends and preferences. The cache of data enables financial institutions to personalize their offerings and create targeted marketing campaigns to deepen engagement. By enhancing the

**Generative AI,** *Continued on page 13*

# You've Implemented CECL, Now What?

*By Brian Finley and Erin Villafana*

Most financial institutions spent months, and in some cases years, preparing to adopt the current expected credit losses (CECL) standard (Accounting Standard Update (ASU) No. 2016-13, Financial Instruments—Credit Losses) in advance of the March 31, 2023, regulatory reports filing. While initial implementation may have passed, there is still work to be done in implementing ASU 2022-02, which eliminates troubled debt restructurings (TDRs) while adding additional disclosure requirements.

Here are seven things financial institutions should continue working on when it comes to CECL:

## Fine-tune your CECL model

Just because you've made your initial CECL entries does not mean you should continue calculating your CECL reserves exactly as you have so far. Instead, monitor how your assumptions and model results are tracking against your realized losses, expectations and other factors, and refine your assumptions to get the best results.

For example, let's say you are using the SCALE dataset in your model. Now that more banks have adopted CECL, would you get better results using data from banks in your region, a specific size range, or banks that have loan portfolios similar to yours? If your model is proving to be overly complex or simple and isn't reacting like you expect in different scenarios, should you look into other options or change some assumptions? Your CECL model and assumptions should not be static. Rather, they should be updated and enhanced with your best estimates and assumptions every quarter.

## Strengthen your documentation

Many institutions rightfully spent the majority of their effort on making their CECL calculations as accurate as possible prior to adoption. Now is the time to go back to your policies and allowance memos and add additional details supporting your key assumptions and decision points. By the time your audit or examination comes, you should have documents that explain your calculation, why you elected to do it that way, and how your significant assumptions were determined. Additionally, there are changes in terminology, accounting standards and regulatory guidance to update in your memos and policies.

## Enhance your controls

With the change to CECL, new data, formulas and reports have become critical to the accurate calculation of your CECL reserves. Ensure you have adequate controls in place so the right data makes it into your calculations, the decisions and assumptions being made are supported, and the calculation is operating as expected.

## Explore the nooks and crannies

CECL is a very broad standard that grants financial institutions a variety of ways to calculate an appropriate allowance for credit losses (ACL). If your institution spent the vast majority of your pre-adoption effort focused on your core loan portfolio, make sure you have properly accounted for CECL in some of the new or more nuanced areas, such as held-to-maturity (HTM) securities, available-for-sale (AFS) securities (other than temporary

**CECL,** *Continued on page 14*

# INVESTIGATING FRAUD – 72 HOURS TO GET IT RIGHT

*By Erik Lioy, Pat Hoan and Zach Powers*

An organization that is well prepared for a fraud incident is one that has already developed a plan that covers a high-level control environment appropriate to the organization, has already explored insurance considerations, and, most importantly, has developed an incident response policy for those "break glass" moments.

While organizations have unique needs, a well-developed incident response policy should have three major characteristics:

- It must be flexible, with the ability to adapt to various types of fraud incidents,
- Potential resources (people, tools, and partners) with the appropriate skill sets and capabilities need to be identified, and
- It should be revisited regularly and updated as necessary.

## Zero Hour

The other shoe has dropped, and you've made the sobering discovery that your organization may be a victim of fraud. Despite the initial shock, it's essential to avoid impulsive actions and begin communicating with the appropriate professionals identified.

Confronting the suspected fraudster is a tempting proposition. After all, this individual may be a close and trusted colleague. Still, it's important to remember that prematurely alerting a fraudster that their scheme has been discovered is a major risk to any investigation.

Further, the well-intentioned effort to immediately collect and start to review evidence such as emails and other electronically stored information (ESI) can result in crucial evidence being destroyed and/or inadmissible. Best practice for mitigating evidence spoliation risk at this stage of an investigation is to leave clues as is, which may feel counterintuitive to the natural urge to secure the "smoking gun." Instead, do your best to secure the potential evidence from outside interference until professionals with the right tools and experience can perform the collection properly.

## First 24 Hours

A few hours removed from the initial discovery is the time to establish your investigative plan. While your incident response policy is the foundation for your investigation, facts specific to the fraud must be considered.

Examples of specific considerations for tailoring your investigation include the scale of the fraud, organizational responsibilities of alleged fraudster(s), legal risks to the organization, ongoing risks to assets and data, and reputational risks. With these considerations in mind, additional questions you should ask include:

***What is the objective of the investigation?*** The scope of an investigation will differ if your objective is to find evidence of noncompliance with rules and regulations rather than to recover misappropriated assets. Do you plan to involve law enforcement or focus on internal disciplinary measures?

***Who are the stakeholders?*** Documentation, communications and evidentiary standards can vary depending on stakeholders. Is this a low-level matter with limited internal stakeholders, or does it involve regulators, law enforcement, business partners, or the broader public?

***Does my team have the requisite competence and independence?*** Employing experienced counsel provides valuable legal privileges to your investigation. It's likely that counsel has experience working with experts across various skills and industries that may be necessary to the investigation's success. Further, the credibility of your findings depends on your team's independence in both fact and appearance.

***Has management been properly quarantined from the investigation?*** Leadership may be used to having unfettered access across their organization. When leadership is implicated in allegations or suspected of wrongdoing, isolating them is paramount to your investigation's success.

***Will this investigation include a root cause analysis?*** Regulators are increasingly asking investigators why incidents happen, not just their extent. Procedures to answer "why" and "how" will likely differ from those designed to answer "what."

## First 48 Hours

With the necessary resources gathered and a plan in place, the time to execute is here. Now the fact-finding process should formally begin through the collection of evidence and conducting interviews. Whether evidence is in the form of paper documents or ESI, maintaining proper chain of custody is essential. Properly documenting collection procedures and storing information in secure repositories can help reduce spoliation risk for potential civil or criminal proceedings.

For ESI, special consideration should be given to who is collecting data and how that data is collected. Forensic technologists specialize in gathering data such as deleted files, temporary auto-save files, and file metadata, among other critical information. Forensic technologists also possess specialized tools that allow for the gathering of volatile evidence not typically available in most organizations.

When conducting witness interviews, the venue and timing have the potential to impact the quantity and quality of information gathered through the process. In general, in-person interviews are more effective (greater ability to read body language, less risk of third-party interference, etc.) than the virtual alternative. Like any other initiative, investigations have resource constraints, and prioritizing which interviews need to be in person can help increase the value you receive from this investigation phase.

Further, being intentional and strategic about the timing of interviews can help reduce the risk of collusion on answers among witnesses and suspects during the process. Best interviewing practices suggest ordering interviews to start with individuals perceived to be the farthest from the incident while working toward the investigation's strongest suspects. As interviews are conducted, the need to follow up with prior interviewees may arise. Accordingly, be mindful of access constraints you may face, especially for high-ranking individuals or individuals in different locations.

## First 72 Hours

The investigation is fully underway at this point, and as circumstances change, your strategy should, too. All investigations will encounter some data, resource and timing challenges. Communication with stakeholders during the onset of the investigation and throughout the process will foster the ability to navigate the challenges inherent in the fact-finding process. Further, proactive communication also will help reduce the organizational impact your investigation may have.

Investigations are inherently lead-driven, and, as such, fact-finding may take you in a different direction over time. While it's important to be adaptive to new information as it becomes available, you should not lose sight of the investigation's scope and objectives you ultimately hope to accomplish. Revisiting your investigative plan at regular intervals is a good way to stay aligned with the scope of your procedures originally agreed to while documenting findings throughout the process.

*Erik Lioy, Pat Hoan and Zach Powers are CPAs with FORVIS, a BHCA Associate Member.* ■

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**Generative AI,** *Continued from page 10*

customer experience, they can increase customer satisfaction and loyalty.

**Improved customer service –** Virtual assistants (chatbots) powered by generative AI can provide round-the-clock customer support, freeing up human representatives to focus on more complex tasks or requests. These chatbots can handle routine inquiries, such as providing account information and assisting with basic financial advice.

**Adaptability to new circumstances –** Generative AI systems can learn and adapt to new information through a process of continuous learning and training. These systems can be retrained to accommodate changes in data, allowing for updated predictions, diagnoses and judgments — which will generate more personalized offers and engagement opportunities with clients. This adaptability enables financial institutions to respond effectively to evolving market conditions and customer needs.

**Flexibility of generative AI –** Unlike traditional AI systems that are designed for specific tasks, generative AI can learn from a wide variety of data and adapt to novel circumstances and tasks. This flexibility allows financial institutions to explore new avenues and address emerging challenges effectively. Whether it's analyzing customer data, identifying patterns, optimizing portfolios or analyzing loan risks, AI can provide real-time solutions for evolving needs.

Generative AI holds immense potential for financial institutions. As the technology continues to evolve and mature, we can expect to see further advancements and applications in the coming years.

Financial institutions that embrace generative AI have the opportunity to enhance customer experiences, automate processes, improve decision-making and strengthen security measures. And when combined with human expertise, generative AI can help financial institutions unlock new possibilities and drive innovation in the industry.

Financial institutions that strategically adopt and implement generative AI have the opportunity to gain a competitive edge and deliver superior services to their customers. With careful consideration of challenges and regulatory requirements, generative AI can propel the financial services industry into the future of innovation and efficiency.

*Billy Collins is a senior manager in the Chicago office of Wipfli, a BHCA Associate Member. This article is reprinted from Wipfli's website with permission.* ■

**President's Obervations,** *Continued from page 4*

at the BHCA and we are spreading the word that membership is most likely a great fit for you. Memberships are in the name of the organization, so everyone who works for your holding company and its subsidiaries is eligible to receive member pricing on registrations for our seminars and other events. This can add up to substantial savings, especially if you and several of your colleagues attend both our Spring and Fall seminars. Watch for a letter or perhaps a phone call or email from a board member inviting you to consider membership. Any organization that joins now would get membership between now and the end of 2024 for the price of one year's dues.

Or, even better, don't wait for someone to contact you! Please feel free to reach out to me or our Managing Director, Tom Bengtson, to get membership information.

Best wishes on the rest of your Fall. I look forward to seeing you at the Fall Seminar! ■

**Down to Business,** *Continued from page 5*

elected officials in Congress are proposing the threshold small bank holding company designation be increased to $10 billion in assets from the current $3 billion. This would lift the regulatory burden for hundreds of bank holding companies. The legislation is focused on holding companies and would not change capital requirements for subsidiary banks.

Both ICBA and ABA are applauding the bill, which includes Rep. Zach Nunn of Iowa among its cosigners.

Rainey said the proposal "will make it easier for small bank and thrift holding companies to raise additional capital, promoting lending and economic growth in local communities..."

Nichols said the bill "will allow community banks to better meet the needs of their customers, clients and communities, while preserving their commitment to safety and soundness." ■

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**CECL,** *Continued from page 11*

impairment is eliminated but impairment considerations still apply), acquired loans, and unfunded commitments.

Remember: Your ACL for unfunded commitments is a liability account separate from your ACL for loans.

### TDRs may be gone, but are you ready for their replacement?

ASU 2022-02 eliminated accounting guidance for TDRs, but it also required enhanced disclosures for modified receivables for debtors experiencing financial difficulty. This includes the requirement to disclose each reporting period, by class of financing receivable:

- Financial effect of modification by type of modification
- Receivable performance in the 12 months following a modification
- TDRs have been eliminated, but many are still evaluating what modifications should be tracked under the new guidance, how best to track them, and what information must be retained for financial reporting purposes. The new guidance simplifies which modifications will require disclosure (you no longer need to assess if a concession was made), but it's important to understand the new disclosure requirements so you're prepared to produce your quarterly regulatory reports and annual financial statements. ASU 2022-02 was effective Jan. 1, 2023, for most entities. The ASU itself has helpful disclosure examples, and the Basis for Conclusions section at the end of the ASU does a nice job laying out the intent behind the changes.

### Plan ahead for financial statement disclosures under CECL

There are numerous new disclosure requirements under CECL that you should familiarize yourself with and begin to build-out well in advance of year-end. The illustrated examples within ASC 326 are a great starting point. In addition to the enhanced modification disclosures discussed above, ASU 2022-02 also clarified the presentation of gross write-offs by vintage.

### Prepare for your next exam

The OCC, FDIC, Federal Reserve, and NCUA put out a Revised Interagency Policy Statement on Allowances for Credit Losses in April 2023 that highlights the need to calculate your CECL reserves in a way that is appropriate for the institution's size and complexity. That phrase is repeated throughout the document, and it's clear regulators will have a wide range of expectations depending on the type of institution. The main thing they are looking for is that the model and assumptions make sense, the institution has adequate documentation to support the assumptions, and ultimately that the ending result is reasonable. Read the Interagency Policy Statement as you're considering ways to enhance your documentation surrounding CECL or in advance of your next exam.

It's amazing how much work has gone into adopting CECL. It's important to keep the momentum going to ensure your institution is fully compliant with the new standard and disclosure requirements.

*Brian Finley and Erin Villafana are both CPAs at Eide Bailly, a BHCA Associate Member.* ■

# Holding Company Transaction Report

Here are selected recent bank holding company filings with the Federal Reserve Banks of Chicago, Minneapolis, Kansas City and St. Louis

▷ One Community Bank, Oregon, Wis., authorized to merge with Farmers State Bank-Hillsboro, Wis., and thereby establish branches. Earlier, the Bosshard Financial Group, Inc., La Crosse, Wis., authorized to acquire shares of One Community Bank and Farmers State Bank-Hillsboro.

▷ Dierk Halverson, Coon Rapids, Iowa; John Chrystal, Aspen, Colo.; and Steven Spotts, Sac City, Iowa, authorized to acquire additional shares of Sac City Limited, and thereby acquire additional shares of Iowa State Bank.

▷ Terre Haute Savings MHC, Inc., Terre Haute, Ind., filed to acquire First Savings Bank, Danville, Ill.

▷ Cosperity Bancorp, Inc., Lee's Summit, Mo., (in formation) filed to become a mutual bank holding company through the acquisition of First Federal Bank of Kansas City, Lee's Summit, upon the conversion of First Federal Bank of Kansas City from mutual to stock form.

▷ Kansas City Bank of Commerce, Chanute, Kan., authorized to merge with Piqua State Bank, Gas, Kan., and thereby establish branches.

▷ Stephen F. Sturm, and others, all of Denver, Colo., filed to become members of the Sturm Family Control Group, and to acquire shares of Sturm Financial Group, Inc., and thereby indirectly acquire ANB Bank, Denver.

▷ CBI Bank & Trust, Muscatine, Iowa, filed to merge with SENB Bank, Moline, Ill., and thereby establish branches.

▷ Independent Bancshares, Inc., Excelsior, Minn., through its subsidiary, Quoin Bancshares, Inc., (in formation) Clarkfield, Minn., filed to acquire Quoin Financial Bank, Miller, S.D.

▷ Petefish, Skiles Bancshares, Inc., Virginia, Ill., authorized to acquire First National Bank of Beardstown, Ill.

▷ Wells Bancshares, Inc., Platte City, Mo., authorized to merge with Connections Bancshares, Inc., Ashland, Mo., and thereby acquire Connections Bank, Kirksville, Mo.

▷ Daniel Plate, Houston, Texas, filed to join the Plate/Juelfs/Forbes Control Group, to acquire shares of Banner County Ban Corporation, and thereby acquire shares of Banner Capital Bank, both of Harrisburg, Neb.

▷ Hoeven Family Limited Liability Limited Partnership, Bismarck, N.D., filed to acquire shares of Westbrand, Inc., and thereby acquire shares of First Western Bank and Trust, both of Minot, N.D.

▷ Lake Central Financial, Inc., Annandale, Minn., authorized to acquire State Bank of Danvers, Benson, Minn.

▷ The Gary W. Paulson and Lyla G. Paulson Revocable Living Trust, Park River, N.D., authorized to acquire shares of First Holding Company of Park River, Inc., and thereby acquire voting shares of First United Bank, Park River, N.D.

▷ FBBT Holdings, Inc., San Francisco, filed to become a bank holding company by acquiring State Bank of Nauvoo, Ill.

▷ Flagship Financial Group, Inc., Eden Prairie, Minn., filed to merge with Security Bancshares Co., and thereby acquire Security Bank & Trust Company, both of Glencoe, Minn.

▷ Central Plains Bancshares, Inc., Grand Island, Neb., filed to become a savings and loan holding company by acquiring Home Federal Savings and Loan Association of Grand Island, upon the conversion of Home Federal Savings and Loan Association of Grand Island from mutual to stock form.

▷ Neal D. Logan, West Des Moines, Iowa, authorized to acquire shares of Garrett Bancshares, LTD, and thereby acquire shares of Success Bank, both of Bloomfield, Iowa.

▷ 1905 Nekota Bankcorp, Inc., Lewellen, Neb., authorized to become a bank holding company by acquiring Lewellen National Corp., and thereby acquiring Bank of Lewellen, both of Lewellen.

▷ Stavros Papastavrou and Sofia Elizabeth Papastavrou, and others, all of Old Westbury, N.Y., authorized to acquire shares of ServBanc Holdco, Inc., and thereby acquire control of Allied First Bank, Oswego, Ill. ■

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