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State of North Dakota DEPARTMENT of FINANCIAL INSTITUTIONS

## A message from Commissioner Entringer

I hope this newsletter finds you all in good spirits despite the weather we have been having this winter. I know personally I am apparently not getting enough sun because I have not been too terribly energetic for a couple of months now. For this quarter's newsletter, I just wanted to mention some things I have noticed while reading examinations or attending exit meetings at the conclusion of examinations. We have seen a higher incidence of violations; including dividend violations, legal lending limit violations and to some extent violations of holding life insurance policies in contravention of our administrative rules. With respect to the dividend violations, I would urge you to utilize the worksheet which is located on our website at http://www.nd.gov/dfi/forms/index.html; the worksheet is fillable and will total the numbers for you. Secondly, if you want to make sure that you are completing the worksheet correctly feel free to send it to us to review. If we see a problem we can correct it and explain what the error was so you don't end up with a violation. The problem with a dividend violation is that it is not correctable – or at the very least not easily correctable! Regarding legal lending limits, here again feel free to confer with us to see if how you are looking at the loan(s) is consistent with the way we will look at the loan. As for the life insurance policy violations, if your bank owns these types of policies I would encourage you to review the administrative rule (http://www.legis.nd.gov/information/acdata/pdf/13-02-14.pdf?20140227170658 ) annually or at least every other year in order to keep up with the limitations within the rule. Here again, feel free to call us and ask questions.

Finally, I did want to give you a bit of advance notice that we are putting together a Day with the Commissioner to be held in Bismarck on May 7th. I assume most of you are aware that the FDIC, in partnership with the North Dakota Bankers Association and the DFI, is offering a one-day Directors College in Bismarck on May 8th.. I am attempting to leverage that opportunity with a Day with the Commissioner the preceding day. Please watch your email for the "official" announcement and the registration forms.

## Facts & Figures

As of December 31, 2013:

- Average Adversely Classified Items Coverage Ratio: 16.87%
- Average Adversely Classified Assets / Total Assets: 1.70%
- Average Adversely Classified Loans / Total Loans: 2.11%
- Average Past Due & Nonaccrual Loans / Total Loans: 1.44%

*Averages are of the 75 North Dakota state-chartered banks.*

*North Dakota Banks*

As of year-end 2013, 96 percent of the North Dakota state-chartered banks had a composite rating of 1 or 2, compared to 82 percent 3 years ago.

## Capital Planning

On January 9, 2014, the State Banking Board rescinded the "Capital Adequacy and Maintenance Policy" of July 18, 1986, since it is considered outdated. Many of you were not aware of this Policy's existence, but our examiners have been monitoring this for the last few decades. One of the Policy's requirements was that a bank should establish a capital plan if capital falls below a certain ratio. This requirement is not outdated though, since a capital plan should be in place regardless of what your level or ratios are. A sound capital plan should not be merely wishful thinking. It should incorporate historical results with realistic expectations for the future, including "worst-case" scenarios. It should take into consideration expected earnings, growth, and dividend requirements. It is important to get a handle on your capital position and develop your plan now, especially given the Basel III requirements which begin to take effect in 2015. On November 4, 2013, the FDIC issued FIL-54-2013, making available a regulatory capital estimation tool to help community banks evaluate the potential impact of the recently published interim final capital rule on their capital ratios. Banks can access the regulatory estimation tool at http://www.fdic.gov/regulations/capital/Bank_Estimation_Tool.xlsm.

## CFPB Qualified Mortgage

On January 10, 2014, the Qualified Mortgage (QM) rule became effective. To assist you with this new rule, the CFPB released the following flyer: http://files.consumerfinance.gov/f/201310_cfpb_qm-guide-for-lenders.pdf. The flyer explains the new requirements in a clear and straightforward language. While it is not a substitute for the actual rule, it covers the main elements that need to be known about QM requirements. Generally, the guide explains how to determine whether a loan meets any of the three main QM categories, including the small financial institution category. If a financial institution has less than $2 billion in assets and originates 500 or fewer first-lien mortgages per year, any loan made that meets certain product features and that are held in the portfolio is a QM as long as the lender has considered and verified a borrower's debt-to-income. (No specific debt-to-income limit applies.) The CFPB has developed additional, plain English compliance guides, videos and a Q&A, which can be found at: http://www.consumerfinance.gov/regulatory-implementation/.

The CFPB flyer notes that:

***Even if a loan is not a qualified mortgage, it can still be an appropriate loan.***

## The OCC's Semiannual Risk Perspective, Fall 2013

Here are some of the risks facing the banking industry, which the OCC outlines in their report:

- Strategic risk remains elevated as many banks re-evaluate their business models and risk appetites to generate returns against the backdrop of slow economic growth and low interest rates. Appropriate risk management processes are important.
- Cyber threats are growing in sophistication and frequency, and require heightened awareness and appropriate resources to identify and mitigate the associated risks.
- Competition for limited lending opportunities is intensifying, resulting in increased risk tolerance and loosening underwriting standards. The recent rise in long-term interest rates underscores the vulnerability for banks that reach for yield, as they could face significant earnings pressure, possibly to the point of capital erosion, if interest rates increase further.
- Bank Secrecy Act and Anti-Money Laundering risks continue to rise as money laundering methods evolve, electronic bank fraud increases in volume and sophistication, and banks fail to incorporate appropriate controls into new products and services.

The full report can be found here: http://www.occ.gov/publications/publications-by-type/other-publications-reports/semiannual-risk-perspective/semiannual-risk-perspective-fall-2013.pdf