AMERICAN BANKER

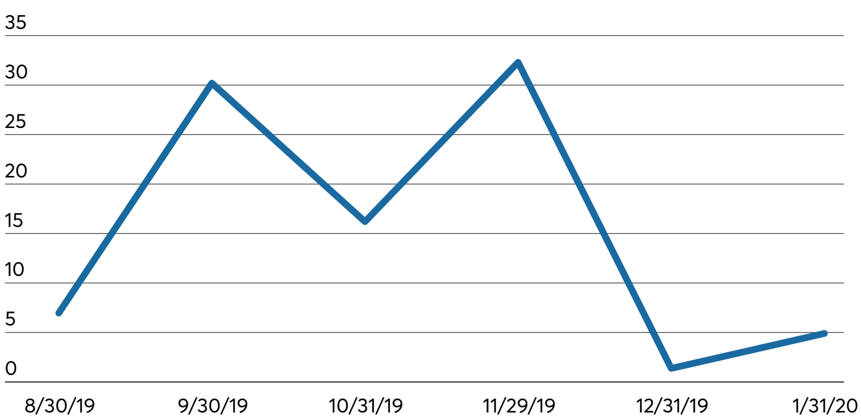
WEDNESDAY FEBRUARY 19, 2020 VOL. 185 No. 33 AMERICANBANKER.COM Follow us on Twitter @AmerBanker

Volatile market

Ethanol industry profits have fluctuated wildly due to easing of EPA requirements, floods and production adjustments that affected demand and input costs

● Return over operating costs (cents per gallon)

See story on page 4



Source: Center for Agricultural and Rural Development, Iowa State University

dailybriefing

1 Lawsuit alleges PNC built payments product with stolen trade secrets

A Denver company says that the $410 billion-asset bank used its confidential information to create a copycat product and poach its customers. PNC is contesting the allegations. **Page 2**

2 Is partisanship seeping into bank regulators' discourse?

Compared with incendiary fights elsewhere in the capital, deliberations among the banking agencies tend to be more banal. But on issues from the Volcker Rule to CRA reform, disagreements lately between officials have grown sharper. **Page 3**

3 Heartland banks have a new worry in turbulent ethanol business

Ag lenders say the Trump administration's waivers for oil refineries threaten another source of revenue for corn growers and ethanol makers. (See chart above.) **Page 4**

4 Three executive defections, one angry investor at New York bank

Hanover Bancorp is facing a proxy battle after its CFO and two other bankers bolted to a rival. **Page 5**

5 Nicolet to buy bank near Milwaukee

The company will pay $130 million for Commerce Financial Holdings. **Page 6**

6 Senate Republicans target banks refusing services to ICE contractors

Five Republican senators want to cut off deposit insurance for banks that have stopped offering financial services to firms that operate detention facilities and private prisons on behalf of the federal government. **Page 6**

7 Retirement wave could leave FDIC short-staffed in crisis, watchdog warns

The inspector general also said high turnover at the chief information officer position has limited the agency's ability to modernize its technology. **Page 6**

8 HSBC restructuring plan gets cold greeting

The bank's announcement that it will slash about 35,000 staff and take $7.3 billion of charges prompted its stock to tumble and renewed questions about the bank's direction and lack of a permanent CEO. **Page 7**

9 Former KeyCorp CEO Henry Meyer dies at 70

Meyer was credited with guiding the Cleveland company through the financial crisis and returning it to profitability. He died this week at his home in Florida. **Page 8**

10 Community banks need reg relief that is more than skin deep

Congress should further expand a tiered regulatory system to help community banks better serve local neighborhoods, Rebeca Romero Rainey of the Independent Community Bankers of America writes. **Page 8**

CORPORATE FINANCE

Lawsuit alleges PNC built payments product with stolen trade secrets

By Kevin Wack
February 17, 2020

About a year ago, PNC Financial Services Group launched an online portal that's designed to eliminate paper-based payments for companies in the middle of a merger or acquisition. PNC Paid is part of a suite of corporate finance products and services that the Pittsburgh company offers and has described as being unique in the banking industry.

But now a Denver-based competitor is alleging that PNC Paid was built on stolen trade secrets. The aggrieved company, SRS Acquiom, wants not only monetary damages from the $410 billion-asset PNC, but also a court order that would essentially force the bank to rebuild its product from scratch.

SRS is suing PNC and two employees of the bank, both of whom left SRS on acrimonious terms in 2018. The Colorado company alleges that Alex Tsarnas and Heather Kelly used their former employer's confidential information to accelerate the development of PNC Paid and to undercut SRS's pricing strategies in an effort to poach its customers.

The suit shines a light on the line between corporate theft and the use of aggressive but still legitimate tactics to gain an edge over competitors.

A spokesperson for SRS Acquiom said that the lawsuit, filed in federal court in Denver, was necessary to defend the firm's rights.

"PNC is a preeminent bank with a strong reputation, which is why we are surprised that it has found the behavior alleged in the complaint to be acceptable," the spokesperson said in a written statement.

A PNC spokeswoman called the lawsuit a meritless effort to eliminate competition.

"PNC did not use any SRS trade secret information to launch its payments and escrow business," bank spokeswoman Marcey Zwiebel said in an email, "and built its online portal from scratch working with a third-party designer."

Kelly and Tsarnas, both of whom still work for PNC, declined to comment.

The high-stakes legal dispute dates to early 2018. SRS fired Tsarnas, its head of sales, in January after allegedly discovering that he embezzled more than $35,000 by deliberately misusing credit cards and falsifying expense reports. Tsarnas has denied those allegations.

Around the same time, PNC purchased Fortis Advisors, a company that offered M&A advisory services to corporate clients, but did not, according to the complaint, have a product that competed with the escrow and payments offerings from SRS.

In March 2018, PNC hired both Kelly and Tsarnas. SRS charges that in the days after Kelly resigned from her old job, she downloaded thousands of the company's confidential files.

After joining PNC, Tsarnas and Kelly participated in development meetings for PNC Paid, according to one of the bank's court filings, which described the two employees as subject matter experts who lent general industry and business experience.

The bank executed its first deal with PNC Paid in January 2019 and publicly launched the product three months later, according to the plaintiff.

"It's what we've been waiting for," Kelly said in an April 2019 text message to Tsarnas, following the public launch of PNC Paid, according to one court filing. "To take SRS down."

SRS, whose clients have included Goldman Sachs and the venture capital firm Andreessen Horowitz, has said in court papers that its suite of software products took six years to build. It contends that PNC was able to develop PNC Paid in roughly a year because it got an unfair head start.

SRS also alleges that the bank's marketing materials for PNC Paid included an image of a nonpublic SRS document. "Defendants did not even bother to change the font style," SRS stated in a court filing. PNC has denied that the document contained confidential SRS information.

Pricing strategies are another major issue in the lawsuit. SRS claims that Kelly retained confidential information that has allowed PNC to target SRS customers by offering an identical product at a lower price. One court filing quoted a June 2019 text message from Kelly in which she anticipated SRS's two biggest clients moving to PNC. "Just makes me so damn happy," she wrote.

In response, PNC points to testimony from another lawsuit in which SRS Chief Executive Paul Koenig said that pricing information is not a secret.

The lawsuit may ultimately turn on the question of what qualifies as a trade secret.

One of the documents at issue in the case is a spreadsheet that SRS says it developed internally over multiple years. It includes detailed templates for collecting relevant

AMERICAN BANKER.

Established 1836
One State Street Plaza, 27th floor, New York, NY 10004
Phone 212-803-8200 AmericanBanker.com

Editor in Chief Alan Kline 571.403.3846
Managing Editor Dean Anason 770.621.9935
Executive Editor Bonnie McGeer 212.803.8430
Washington Bureau Chief Joe Adler 571.403.3832
Editor at Large Penny Crosman 212.803.8673
BankThink Editor Rachel Witkowski 571.403.3857
Community Banking Editor Paul Davis 336.852.9496
Technology Editor Suleman Din 212.803.8738
Contributing Editor Daniel Wolfe 212.803.8397
Digital Managing Editor
Christopher Wood 212.803.8437

Copy Editor Neil Cassidy 212.803.8440

Reporters/Producers
Laura Alix 860.836.5431, Kate Berry 562.434.5432
Jim Dobbs 605.310.7780
John Heltman 571.403.3847
Hannah Lang 571.403.3855
Ken McCarthy 724.996.2188, Andy Peters 404.500.5770
John Reosti 571.403.3864, Gary Siegel 212.803.1560
Jackie Stewart 571.403.3852
Kevin Wack 626.486.2341

information from deal parties, according to SRS. The company alleges Kelly sent the spreadsheet to her personal email and shared it with PNC, which then used it to develop PNC Paid.

PNC has described the same document as "a blank excel file."

"This is a trade secret case with zero secrets," the bank stated in a December court filing.

SRS, which is majority owned by the private equity firm Lovell Minnick, is seeking a preliminary injunction against PNC. Such an order could force the bank to pull its existing product out of the market until it can develop an untainted version. U.S. District Judge Daniel Domenico has scheduled a hearing for March 11.

The PNC spokeswoman said that the company looks forward to disproving the lawsuit's claims in court.

"PNC has a strong corporate governance program," she said, "which includes procedures to ensure that all employees honor their contractual obligations and that PNC does not obtain or use another company's proprietary or confidential information … ".

CRA

Is partisanship seeping into bank regulators' discourse?

By Brendan Pedersen

February 16, 2020

WASHINGTON — Compared to more incendiary fights in the capital, bank regulatory debates are traditionally more banal — led by officials who strive for consensus and leave their disagreements in the backroom.

But on recent policy issues ranging from the Volcker Rule to the Community Reinvestment Act, divisions among regulators have lately appeared sharper, more along political lines and more out in the open.

"Regulators aren't always interested in singing off of the same sheet of music," said V. Gerard Comizio, senior counsel at Fried Frank and a former attorney at multiple regulatory agencies. "But at the agencies where you have boards and commissions, there now are harder edges to the disagreements."

The heightened discord was illustrated last month at a board meeting of the Federal Deposit Insurance Corp. to propose rolling back "covered fund" restrictions in the Volcker Rule.

Martin Gruenberg — the Democratic-appointed FDIC board member and former chairman, who has opposed nearly all the regulatory relief measures issued during the Trump administration — spent nearly 20 minutes tearing into the proposal. That followed his 11-minute dissent on a final rule amending a disclosure requirement.

Comptroller of the Currency Joseph Otting, who holds a seat on the FDIC board, had heard enough. He said the proposal would allow activities that were not intended to be targeted by the Volcker Rule.

"Unlike my colleague on the board who has a tendency to cry wolf whenever we modify these rules to ensure that capital reaches American consumers and businesses, I feel these changes help to focus on the activities that present, really, the greatest dangers to our financial system," Otting said, looking at Gruenberg. The remark turned heads around the room and prompted Gruenberg to sit back in his chair, eyebrows raised.

Such a comment directed at a policy opponent is commonplace in Congress, the mainstream press or social media. But the moment underscored what many see as a stark reality: the ability of the regulators to walk in lockstep is cracking.

"For a long time, the banking agencies were immune from polarization," said one former senior regulator who spoke on the condition of anonymity. "But this is a reflection of the climate — it's a reflection of a current administration that's comfortable trampling on norms."

To be fair, the agencies agree more than they disagree. Concerns raised by Democratic appointees such as Gruenberg and Federal Reserve Board Gov. Lael Brainard about reforms they say are too generous to the industry are heard, but then the agencies — all led by Trump administration appointees — still move forward.

In a statement to American Banker, Otting downplayed any conflict between the agencies or board appointees, describing 2019 as "a banner year for rulemaking and cooperation." He argued that the agencies are in sync.

"That work could not have been achieved without the positive cooperation among all of the regulators at the staff and leadership levels," Otting said. "We should not mistake discourse for constructive dialogue and keep in mind that healthy debate often leads to better decision-making."

Tom Curry, Otting's predecessor at the Office of the Comptroller of the Currency, agreed that there is nothing exceptional about the recent disagreements among regulators.

"In a policy speech, at a board meeting — these are appropriate places to lay out policy positions or disagreements from the minority," said Curry, a partner at Nutter. "You're laying out arguments one way or the other. If everyone agrees all the time, what good is it?"

But for many outside government, a new tone in agency deliberations has been difficult to ignore. A clear sign, they say, is the wedge between the OCC and Fed on how to reform the agencies' CRA framework.

After the Fed decided not to sign on to the OCC and FDIC's proposal to modernize the CRA, Brainard made headlines when she delivered a policy speech that outlined the Fed's objections, saying "it is much more important to get reform right than to do it quickly."

Otting, later meeting with reporters, dismissed Brainard's remarks. He suggested that since the Fed has not yet released its own proposal, it is hard to take Brainard's comments seriously. (Fed Chairman Jerome Powell has since endorsed Brainard's speech.)

"If you really think about it, I could give a speech on tiddlywinks tomorrow," Otting said, referring to a children's board game.

Many observers said the current tenor of debates deviates from what had been the norm under previous leadership of the agencies. Regulators butted heads behind the scenes, and sometimes in public, but officials strived to reach consensus in final rules across agencies and political parties.

A notable example was the effort in 2014 to raise a key capital measure for large banks known as the leverage ratio. At the time, Gruenberg ran the FDIC and the Fed board was chaired by Ben Bernanke, originally appointed in the George W. Bush administration. With former FDIC board members Thomas Hoenig and Jeremiah Norton — both recommended for the board by the GOP — pushing for a tougher capital standard, all three agencies eventually agreed on a final standard.

"Go back even five years, and there was much more consistency between the two boards [of the FDIC and Federal Reserve] and the comptroller," said Mike Krimminger, a partner at Cleary Gottlieb and former general counsel for the FDIC. "There was widespread agreement on capital rules, interaffiliate margin swaps, etc. There were certainly disagreements behind closed doors, but the conflicts were muted."

Comizio said forming a consensus in rulemaking is important to reach a policy outcome that is sustainable from one administration to the next, while partisan disagreement can have the opposite effect.

"It boils down to the question of whether the respective parties, majority and minority, are actually dealing with and listening to senior staff," he said. "Everyone needs to be willing to have an open mind and hear everyone else out, blend the ideas and come up with a joint approach. If you don't, the credibility and gravitas of the regulators comes into question.

"If an agency is constantly handing down rules with dissent — substantial, major dissent — that can have a destabilizing effect, even if the industry likes the rules. Administrations change."

Gruenberg's policy dissents — always lengthy and technical — have become almost as commonplace as rulemaking itself at the FDIC. In the past 12 months, Gruenberg has dissented on proposed changes to the CRA, brokered deposit rules, swap margin requirements, and more. Brainard has similarly dissented from moves by the Fed board under Powell and Vice Chair for Supervision Randal Quarles.

Yet those dissents have not impeded the policy priorities of the Trump administration-appointed regulators, and the industry has lauded the agencies for simplifying and streamlining pieces of the Dodd-Frank Act regulations.

Some observers said today's conflicts may be less about policy disagreements or breakdowns in communication than simple party alignment.

"If you look at the political persuasions of the dissenters versus the reformers, it's suggestive of what's going on," said Lawrence Kaplan, chair of bank regulatory policy at Paul Hastings. "You have Republican appointees on the one side coming in, making changes to what is typically viewed as burdensome sets of rules, recognizing that sometimes a rule doesn't work as intended. But when you look at other policymakers who were appointed by Democrats, they often are only trying to protect rules adopted by prior administrations."

"One camp says no changes can be made — that it's not appropriate, while the other says changes are needed," Kaplan said. "In effect, these become ideological positions."

AG LENDING

Heartland banks have a new worry in turbulent ethanol business

By Jon Prior
February 12, 2020

Banks in corn country are worried the once booming ethanol business has reached its peak as profits have been pinched by low prices, bad weather and the Trump administration's moves to curb ethanol use.

The price of a gallon of ethanol is down more than 16% since last summer when the Environmental Protection Agency waived renewable fuel requirements for a new batch of oil refiners.

As refiners needed to buy less ethanol, the move saved the oil industry millions, while ethanol producers — which include farmers and other customers of ag banks — took a hit to their bottom line.

Average profits on a gallon of ethanol declined in the fall of 2019 following the announcement of the waivers. Margins rebounded some as plant owners improved their efficiencies while others idled production, according to data from Iowa State University.

But profits tumbled again at the end of the year as corn prices ethanol producers were paying rallied. Massive flooding across the Midwest earlier in 2019 damaged corn harvests in the fall, leaving supply low and raising production costs for ethanol.

As demand continued to wane, margins briefly went negative at the start of the year, meaning producers were actually losing money. Profits settled at less than 5 cents per gallon at the end of January, still a fraction of the more than 60 cents per barrel in 2016, the data show.

The up-and-down episode that played out over the months following the Trump administration's announcement of the refinery waivers marked a kind of volatility better known in the oil and gas trade.

Nate Franzén, president of the agriculture banking division at the $1.7 billion-asset First Dakota National Bank in Yankton, S.D., said while he has not heard of any lenders pulling back credit from ethanol producers yet, there is a lot of "turbulence" in a market that may have its best days of dependable demand behind it.

"There's certainly a lot of things that would tell you it's leveled off," Franzén said.

Problems in the ethanol business are part of wider struggle across ag banking as farmers have been dealing with falling commodity prices for years. Recent trade spats between the Trump administration and buyers of U.S. crops abroad have made matters worse, and the Federal Deposit Insurance Corp. even warned banks about ag financing risks in January.

Many ethanol plants were set up by farmers themselves as a way to diversify their revenue, said Jeff Plagge, superintendent of the Iowa Division of Banking. While Plagge noted that at least two nearby plants have closed recently, the problems have not become too serious for ag banks that lend to ethanol producers.

However, ag banks are watching the Trump administration's decisions on ethanol carefully, Plagge said.

The EPA has granted 66 waivers to oil refiners for the 2017 and 2018 compliance years, almost twice the amount for the previous four years combined, according to the U.S. Energy Information Administration.

"These waivers will determine the long-term direction" of the ethanol market, Plagge said.

First National Bank of Omaha Senior Vice President Tom Jensen, who heads up the the $22.1 billion-asset lender's agribusiness, correspondent banking and renewable fuels departments, said the biggest banks have left the ethanol business.

Producers have relied more on community banks, which could mean more of an opportunity for smaller lenders as plant owners look for financing needed to make upgrades. Just as declines in oil prices recently have forced drillers to pump crude at lower and lower costs, ethanol producers have to make investments to keep expenses down.

"In the commodity business you gotta be a low-cost producer to survive the trials," Jensen said.

There remains some hope that a preliminary trade deal with China could help ethanol producers export more of their fuel abroad and give rise to prices again.

"If China enters the market this year, the boost to ethanol exports looks to place corn use for ethanol above current [U.S. Department of Agriculture] forecasts," Todd Hubbs, a clinical assistant professor of agricultural commodity markets at the University of Illinois, said in a Feb. 10 research note.

The trade war with China has led to more ag banks sliding into the red already. They have been buoyed indirectly by $23 billion in trade assistance the USDA has earmarked for farmers. Plagge, at the Iowa Division of Banking, said it was critical that these agreements benefit the ethanol business and corn country as a whole because government checks won't always be in the mail.

"Those won't continue forever. All these trade agreements that were signed, we really need to see them come to fruition," Plagge. "That's going to be the real test going forward."

COMMUNITY BANKS

Three executive defections, one angry investor at New York bank

By John Reosti
February 14, 2020

What a difference a few months makes.

Hanover Bancorp in Mineola, N.Y., bought Chinatown Federal Savings Bank in New York last summer. The $862 million-asset company seemed to be in great shape to conduct a long-awaited initial public offering.

Instead, Hanover is embroiled in a bitter dispute with a longtime investor, who recently accused Chairman, President and CEO Michael Puorro of insider dealing and stacking the deck against legitimate management challenges.

Hanover is also engaged in a caustic fight with First Central Savings Bank after filing a lawsuit in Nassau County Supreme Court against three former executives who quit to join the Glen Cove, N.Y., competitor in October. Hanover alleges the trio took proprietary information with them when they left.

Hanover is also trying to remove John Sapanski, the father of one of the three defectors, from its board. Kenneth Sapanski had been Hanover's chief credit officer.

Bankers quitting to join rival institutions is a common occurrence in the industry. Earlier this month, the $2.6 billion-asset Sierra Bancorp in Porterville, Calif., announced that it had hired two teams from neighboring banks.

Liftouts seldom produce this level of acrimony, and Hanover's disputes threaten to overshadow record profit and plans for an IPO.

A large amount of the angst is tied to the executives' departures.

Joseph Pistilli, First Central's chairman, said the Hanover bankers left because of problems at the bank. The exodus "reflects the ongoing hemorrhaging of top-flight talent from Hanover which has occurred over the past several years," Pistilli said in a statement.

Pistilli labeled Hanover's lawsuit "meritless," and said Puorro "has unnecessarily wasted hundreds of thousands of dollars of his shareholders' money on expensive attorneys fees in his desperate attempt to hide his responsibility for the flight of these talented professionals and the harm he has done and is doing to his institution."

Hanover's issues date back to at least June 2018, when Paul Hagan, the company's chief financial officer from 2011 and 2017, called on Hanover to separate the roles of chairman and CEO. Hagan joined the $595 million-asset First Central last June as president and chief operating officer.

Now, Brian Pun, a developer who has been a Hanover shareholder since December 2013, is seeking three seats on Hanover's board.

"The status quo at Hanover is unacceptable and change at the board level is urgently needed to stop further erosion of shareholder value," Pun wrote in a letter he sent to Hanover shareholders Monday.

Pun referenced the departed executives as part of a claim that Puorro "is unable to retain talent." Pun also complained that Puorro received stock options totaling nearly 41,000 shares in both 2018 and 2019, calling the awards "an unprecedented, excessive, and unconscionable amount of equity compensation, particularly given the fact that the shareholders have never received a dividend."

Puorro responded on Wednesday, noting in a shareholder letter that Pun's real estate firms have reaped fee income totaling hundreds of thousands of dollars from clients referred by Hanover. Pun and his son "are indebted to the bank for millions" in loans, the letter added.

"Make no mistake, Mr. Pun's efforts risk the value of your investment and may ultimately deny shareholders a long-awaited" IPO, Puorro added.

Hanover is asking shareholders to re-elect three incumbent directors.

The response ignores Hanover's corporate governance shortcomings and a lack of coherent strategy, a spokesman for Pun said. He said the comments about Pun's borrower status are "akin to General Motors criticizing one of its shareholders for owning a Chevrolet."

Pun won a small legel victory that forced Hanover to move its annual meeting date from Jan. 30 to Feb. 21.

"Instead of simply ... giving me the right to nominate and let shareholders decide ... I was forced to go to court and litigate the issue," Pun wrote in his letter.

Hanover is hinging much of its defense on its growth trajectory under Puorro's leadership. The bank had one branch and $54 million in assets when Puorro became CEO in 2012. At the end of 2019, the company had $732 million in loans. Its tangible book value has more than doubled in the last eight years, to $17.48 a share at Dec. 31.

Hanover's earnings jumped in 2018, reflecting aggressive growth in adjustable-rate mortgages.

"Management is focused on positioning Hanover to access the capital markets for the benefit of all shareholders and will not allow false allegations made by those with questionable motives derail Hanover from this course," Hanover spokeswoman Brandy Bergman said.

Puorro has indicated that Hanover needs to reach $1 billion in assets to successfully pursue an IPO, a threshold that doesn't seem too far off given the company's recent growth spurt.

"We are working hard each and every day to position Hanover for a potential initial public offering," Puorro wrote in his letter.

COMMUNITY BANKING

Nicolet to buy bank near Milwaukee

By Paul Davis
February 18, 2020

Nicolet Bankshares in Green Bay, Wis., has agreed to buy Commerce Financial Holdings in West Bend, Wis.

The $3.1 billion-asset Nicolet said in a press release Monday that it will pay $129.6 million in stock for the $708 million-asset Commerce. The deal, which is expected to close in the third quarter, priced Commerce at 190% of its tangible book value.

The exchange ratio can be reset if Nicolet's stock price rises above $82 a share or falls below $62 a share.

"In each merger, we have purposefully found partners who focus on serving customers and the community," Bob Atwell, Nicolet's chairman and CEO, said in the release. "When we combine our resources and cultures, we can positively impact the community banking landscape of Wisconsin."

Joe Fazio, Commerce's CEO, will join Nicolet's board. Tom Hopp, Commerce's president, and Dave Borchardt, the company's chief financial officer and chief operating officer, will join Nicolet's bank.

Bryan Cave Leighton Paisner advised Nicolet. Hillworth Bank Partners and Reinhart Boerner Van Deuren advised Commerce.

DEPOSIT INSURANCE

Senate Republicans target banks refusing services to ICE contractors

By Neil Haggerty
February 14, 2020

WASHINGTON — Senate Republicans have introduced a bill targeting banks that refuse to offer depository services to contractors that operate facilities on behalf of the Immigration and Customs Enforcement Agency.

The Financial Defense for Industrial Contractors Act, or FDIC Act, would remove FDIC insurance from banks with assets over $50 billion that refuse to provide banking services to firms with an active federal contract and are otherwise creditworthy and law-abiding. The legislation is co-sponsored by Sens. Marco Rubio, R-Fla., Kevin Cramer, R-N.D., Tom Cotton, R-Ark., Marsha Blackburn, R-Tenn., and Ted Cruz, R-Texas.

"Some of our nation's largest banks have decided to cater to the radical left's 'woke' agenda by abusing their systemic influence in our economy to deprive law-abiding federal contractors of banking services critical to their business," Rubio said. "Banks have a right to deny funds to certain businesses, but they shouldn't enjoy taxpayer-provided guarantees if they are undermining the public policy of the United States."

The bill is in response to six big banks' decision to stop offering depository services to contractors that operate facilities on behalf of ICE. Those banks are Wells Fargo, JPMorgan Chase, Bank of America, BNP Paribas, Barclays and SunTrust.

"The Immigration and Customs Enforcement Agency employs contractors to help enforce the immigration laws that keep Americans safe," Cotton said. "By denying critical financial services to ICE contractors, big banks have hobbled ICE's efforts to protect Americans. These banks shouldn't receive public funding if they're putting the public at risk."

Republican senators have introduced similar legislation in response to certain banks' refusal to provide financial services to certain firearms firms. Cramer and Sen. John Kennedy, R-La., introduced a bill in March 2019 that would ban banks from denying service to certain constitutionally protected industries, such as firearms.

While Republicans control the Senate, neither bill is likely to make headway in the Democratic-controlled House. Several Democratic lawmakers have lauded banks that have cut ties with firearms firms and private prisons.

FINANCIAL REGULATIONS

Retirement wave could leave FDIC short-staffed in crisis, watchdog warns

By Brendan Pedersen
February 14, 2020

WASHINGTON — The internal watchdog for the Federal Deposit Insurance Corp. reiterated concerns that the agency is facing a potential retirement wave over the next five years that could deplete its institutional knowledge and challenge its capacity to respond to a financial crisis.

In a report released Friday morning, the FDIC's inspector general also said that high turnover among chief information officers over the past decade has limited the agency's ability to modernize its IT infrastructure.

The report was part of a standard review conducted by Inspector General offices throughout the government, identifying management challenges at respective agencies, as required by the Reports Consolidation Act of 2000.

The report typically summarizes recent IG findings and gives strategic recommendations for the year ahead. But of particular note in recent years has been the FDIC's aging workforce; according to the Government Accountability Office, just over 31% of the permanent federal workforce will be eligible to retire within five years. At the FDIC, however, 42% will hit retirement age by 2024.

The IG first noted the FDIC's looming retirement figures in 2019.

"Although historical FDIC projections show that employees may not retire on their eligibility date, this wave of potential retirements could deplete the FDIC's institutional experience and knowledge, especially during a crisis," the report said.

A retirement wave over the next decade could also be exacerbated by staffing trends at the agency: according to the IG report, the FDIC has hired progressively fewer staff members for nine consecutive years, including a net reduction of 182 positions between 2018 and 2019. The report notes that the staffing reflects "the FDIC's reduced bank failure workload" from the heights of the financial crisis a decade ago.

Among the FDIC's regional offices, Dallas could be hit particularly hard by a retirement wave. According to the report, 53% of the current workforce will be eligible to retire by 2024, along with 77% of its executives and managers. The trend is particularly concerning, the IG says, given the Dallas office's historic capability for managing large-scale bank failures.

"Retirements and attrition can create opportunities for employees and allow organizations to restructure to meet program goals and fiscal realities," the report said. "However, if turnover is not strategically monitored and managed, gaps can develop in an organization's institutional knowledge and leadership."

On the IT side, the FDIC has been dinged by its watchdog in the past for being sluggish on updating its own legacy technology. Part of the problem, Friday's report said, has had to do with executive turnover.

The appointment of a new information chief in January, the report noted, "marks the FDIC's eighth CIO or Acting CIO in the last decade." Referring to findings by the Government Accountability Office, the report said that "high turnover rate in CIOs negatively impacts their effectiveness because there is limited time to put their agenda in place or form close working relationships with agency leadership."

The report also urged the agency to focus on keeping pace with fintech development, ensuring crisis readiness and strengthening its own governance, among other management priorities.

EXPENSE MANAGEMENT

HSBC restructuring plan gets cold greeting

By Bloomberg News
February 18, 2020

HSBC Holdings Plc Chairman Mark Tucker promised a strategy reboot. Investors got what some called more of the same — pledges to cut costs and do more with less.

The shares fell by the most since 2017 after buybacks were shelved for two years and the executives themselves said more bad news was still to come — once they assess the economic damage wrought by the novel coronavirus.

In the overhaul announced on Tuesday, HSBC will slash about 35,000 staff — 15% of the total — and take $7.3 billion of charges, while it doubles down on Asia, source of most of the bank's profit, and cuts operations in the U.S. and Europe. Left hanging was interim Chief Executive Officer Noel Quinn as Tucker and the board consider a permanent appointment.

"I wish we hadn't had HSBC shares this morning," said Alan Beaney, CEO at RC Brown Investment Management. "I am not quite sure why Quinn has not been named CEO now given they have allowed him to cut 35,000 jobs and make a number of strategic decisions. It does not make sense to me."

HSBC Chief Financial Officer Ewen Stevenson said the bank would be "ruthless" in executing its plan — the giant's third strategic overhaul in a decade — but he has an uphill struggle persuading shareholders. "The board is asking the market to take an enormous amount on trust," said analysts at Keefe, Bruyette & Woods, the specialist financial-services broker.

London-traded shares in HSBC, Europe's biggest bank by market value, tumbled as much as 7% to 549.50 pence, wiping out its gain so far in 2020.

While Tucker is returning the bank — founded in 1865 as the Hongkong and Shanghai Banking Corp. — to its roots with the sharpened focus on Asia, analysts noted the shortage of detail on how it plans to grow there.

For bank strategists, there might be a case of déjà vu: a 2018 plan by Quinn's predecessor, John Flint, fell flat on arrival. Flint was fired 13 months later. Tucker, who was hired in 2017 to revive growth at the sprawling lender, is still struggling to answer investors' question of why a bank with such a strong hold in some of the world's fastest-growing economies has been unable to produce a better return.

The latest plan envisages cuts to underperforming businesses and regions, in particular HSBC's global banking and markets unit, which houses its investment bank. The bank has said it will reallocate $100 billion of risk-weighted assets to areas where it can make more money. The job cuts will put total staff at about 200,000.

"Parts of our business are not delivering acceptable returns," Quinn said.

By 2022, HSBC will increase risk-weighted assets devoted to Asia to 50% from about 42%.

The fresh strategy makes sense but is "on the conservative side," Alan Higgins, chief investment officer of Coutts & Co., said on Bloomberg television.

The main points of the bank's earnings report Tuesday included:

- HSBC's adjusted pretax profit of $22.2 billion beat estimates, despite the multibillion-dollar charge for the restructuring. HSBC had been forecast to report adjusted pretax profit of $21.8 billion, according to analysts.
- The bank plans gross asset reduction of more than $100 billion by the end of 2022, and a lowered cost base of $31 billion or less by 2022.
- Consumer banking and private banking will be merged into a single wealth platform.

- Global banking and commercial banking middle and back offices to be combined.
- Geographic reporting lines will fall from seven to four.

"We are intending to exit a lot of domestically focused customers in Europe and the U.S. on the global banking side," Stevenson said in a Bloomberg Television interview.

Execution aside, the unknown remains the impact of the coronavirus. Stevenson estimated possible losses in the first-quarter of 2020 at between $200 million and $500 million. Executives said on a conference call that the loan book has shown "great resilience" so far in the face of the outbreak.

"While reduced capital allocation to low-return businesses is a positive, we expect weaker profitability in what have traditionally been strong markets, primarily Hong Kong," Morgan Stanley analysts wrote, maintaining their underweight rating on HSBC.

OBITUARIES

Former KeyCorp CEO Henry Meyer dies at 70

By Allissa Kline
February 14, 2020

Henry Meyer III, the former chairman and CEO at KeyCorp who guided the Cleveland company through the financial crisis, has died at the age of 70.

Meyer died Feb. 11 in his sleep at his home in Naples, Fla., according to a report Friday in The Plain Dealer in Cleveland.

Meyer began his four-decade career in banking when he joined Society National Bank in Cleveland in 1972. He worked his way through the management ranks and became president and chief operating officer in 1990 and was elevated to CEO in 1993. He joined the board in 1994, the same year Society merged with KeyCorp, which at the time was based in Albany, N.Y., in a deal that created a regional bank with nearly $70 billion of assets.

In 1995, Meyer was appointed chief operating officer of the combined institution. Two years later, he was named president and in 2001 he became chairman and CEO.

Current KeyCorp Chairman and CEO Beth Mooney, who succeeded Meyer in 2011, said she "cannot understate the impact Henry had" on the bank.

"KeyBank's longstanding culture of helping clients and communities thrive has its roots in Henry's leadership," Mooney said in a statement. "He helped build a strong focus on ensuring that Key is a diverse and inclusive company, understanding that not only was it the right thing to do, but that it was also good business."

Mooney, who will step down as CEO of the now $146 billion-asset company in May, credited Meyer with providing "a steady hand" during the financial crisis. The company lost about $2.3 billion in 2008 and 2009, but reduced its risk profile and returned to profitability by 2010.

Meyer was a 1972 graduate of Colgate University in Hamilton, N.Y., and earned an MBA from Harvard Business School in 1978. In addition to his professional life, he was active in the community, serving as chairman of the boards at University Hospitals Health System, University Hospitals of Cleveland and the United Way of Greater Cleveland. He also served on the board of the Federal Reserve Bank of Cleveland and was a member of the Federal Advisory Council of the Federal Reserve System.

BANKTHINK

Community banks need reg relief that is more than skin deep

By Rebeca Romero Rainey
February 13, 2020

Main Street community banks have achieved regulatory relief from Washington's expansive response to the Wall Street financial crisis. But it should not stop there.

These hard-fought carve-outs address the disproportionate impact of regulatory burdens on community banks and recognize the need for a tiered regulatory system based on institutional size and complexity.

In order to allow continued access to financial services in local communities and to promote equitable economic growth in every corner of the country, policymakers should keep advancing reforms that support community banks, and the communities they serve.

The 2008 market crash wrought by too-big-to-fail financial institutions not only flattened the economy — and many community banks along with it — but also unleashed a flood of new regulations for banks that bore no responsibility for a calamity caused by lax underwriting and complex financial instruments.

Community banks found themselves dealing with both a crisis they did not cause and new regulations designed for practices in which they don't engage, such as risky mortgage lending and proprietary trading.

As a result, community banks were forced to spend more time and resources meeting regulatory demands, with many leaving the mortgage market entirely, undermining access to credit in local communities.

In response, community bankers worked diligently for years to advance reforms targeting excessive and unnecessary regulatory burdens that inhibit access to local credit for U.S. consumers, small businesses and farmers.

Those efforts culminated in the enactment of the bipartisan Economic Growth, Regulatory Relief and Consumer Protection Act of 2018, which refined regulations for qualifying community banks.

Since then, community banks have posted strong results. For instance, they outperformed the rest of the banking industry during the third quarter of 2019, while continuing to demonstrate their safety and soundness with higher capital ratios and better loan quality than larger institutions.

Meanwhile, the community bank presence in both urban and rural markets continues to outpace that of larger banks. And these institutions focus a relatively large share of their resources in low- and moderate-income tracts, helping serve the credit needs of those who need it most.

Nevertheless, there is plenty more that Washington can do to support a more safe, efficient and equitable regulatory regime for community banks.

Pending updates to the Bank Secrecy Act requiring companies to disclose their own "beneficial" owners when they are formed would modernize the compliance regime while providing more useful data to law enforcement.

Closing the industrial loan company (ILC) loophole would ensure the dangerous mixing of banking and commerce doesn't fuel the next financial crisis. Congress enacted a three-year ban on ILC charters after the last financial crisis but needs to close the loophole once and for all.

Finalizing legislation recently passed in the House that creates a cannabis-banking safe harbor in states where cannabis is legal would address regulatory compliance concerns, and improve public safety by reducing cash-motivated crimes.

Continuing to make the new Current Expected Credit Losses accounting standard more flexible and workable for community banks would help them better align their financial forecasting with these complex standards.

Also, leveling the tax and regulatory playing field with the Farm Credit System and tax-exempt credit unions would offset these financial firms' government-provided competitive advantages.

Community banks remain the banking sector's gold standard, with robust capital ratios and the lowest levels of risk and complexity due to their locally focused, relationship-based business model.

Rather than finding new ways to apply Wall Street regulations to Main Street community banks, policymakers should continue building and maintaining a tiered regulatory system. This should be a system that recognizes and rewards banking that is accountable and accessible to local communities.

Rebeca Romero Rainey is president and CEO at the Independent Community Bankers of America.

VARIABLE-RATE BONDS

New York blocks banks from dismissing VRDO lawsuit

By Kyle Glazier
February 14, 2020

The state of New York has blocked dismissal of a lawsuit accusing several major banks of wrongdoing in the variable-rate market, effectively preventing those banks from using the argument that has offered success to them in several similar lawsuits filed around the country.

The office of New York Attorney General Letitia James notified the Supreme Court of the State of New York via filing Thursday it is blocking dismissal of a "meritorious" whistleblower suit on public disclosure grounds.

The move is significant because the banks won dismissal of a similar lawsuit in Massachusetts on those grounds, and the public disclosure bar was arguably the crux of the banks' argument in the pending motion to dismiss in New York.

"Because the state has the right to block a defendant's attempt to have a meritorious case dismissed on public disclosure grounds … once the government objects [to dismissal on a public disclosure ground], the court does not even address the issue," wrote Bryan P. Kessler, a senior counsel in the Taxpayer Protection Bureau of James' office.

At the heart of the accusations raised by the suit in New York, as well as similar ones elsewhere, is the banks "bucketed" large groups of variable-rate demand obligations and set their rates en masse, without regard to the characteristics of the securities, which the lawsuits argue is a violation of the remarketing agreements binding those banks. Those agreements generally commit remarketing agents to try their best to set the rates at the level necessary to market the bonds at par.

Suits filed in Illinois, New York, Massachusetts and California all stem from Johan Rosenberg, a Minnesota-based municipal advisor, who said he found the "robo-resetting" scheme after his own analysis led him to uncover the alleged misconduct. He originally filed his lawsuits under the name of a corporate entity called "Edelweiss Fund," before a court ruled he would need to make his identity public to continue his litigation.

The defendant banks, or their subsidiaries, which include JPMorgan Chase & Co., Citigroup, M&T Bank Corp., Merrill Lynch & Co. and Morgan Stanley Smith Barney, seek dismissal based on several contentions, including the public disclosure bar — a legal standard in New York and elsewhere — that exists to prevent whistleblower lawsuits from being filed on the basis of public information.

The banks have argued that because VRDO reset rates and other information about the securities is public knowledge, the lawsuits fail on that basis. The argument succeeded in Massachusetts, where a trial court dismissed a suit last year, a decision Rosenberg's legal team is appealing.

The stakes are high in New York, where the alleged damages total some $374 million, though that amount could fall if the court accepts the banks' argument that the state is not a party to the remarketing agreements in conduit deals. Rosenberg's legal team has asserted that banks are still liable with respect to conduit deals, because they made "false claims" to the paying agents involved, who are "agents of the state."

The filing from James' office is not the same as an intervention in the suit, which occurs when a government joins the whistleblower as a plaintiff. It only determines the suit is meritorious enough that it should not be dismissed on the basis of the public disclosure bar.

"The state takes no position on any of the other issues raised in defendants' motions to dismiss," Kessler wrote.

In court filings, the defendant banks have denied wrongdoing. ❑