The Arizona Banker

PUB. 10 2021 ISSUE 1

Your Fair and Responsible Banking Program in 2021 and Beyond

Official Publication of the Arizona Bankers Association

shield compliance
ShieldBanking.com

What will drive your core earnings growth?

Consider cannabis banking.

Is your financial institution seeking new sources of low-cost deposits and non-interest income? If so, it may be time to consider banking the booming cannabis industry.

As net interest margins compress, cannabis banking provides a low-cost funding engine, delivering service charge revenue with low-cost deposits.

Learn how your financial institution can unlock the benefits of a safe and scalable cannabis banking program and gain a first-mover advantage in this fast-growing industry.

Get started at ShieldBanking.com

Cannabis banking, simplified.

Shield Compliance transforms how financial institutions manage risk, comply with regulations, and address the operational demands of the legal cannabis industry.

shield
assure
BSA/AML compliance management to monitor, measure, and control your financial institution's cannabis banking program.

shield
engage
New client application and underwriting to accelerate speed to market.

shield
transact
Payment enablement for compliant cashless transactions.

Contact us to learn how Shield Compliance is helping financial institutions earn the benefits of a cannabis banking program.

Brian Storey
Business Development Officer
brian@shieldbanking.com
(425) 276-8238

Richard Drennen
Business Development Officer
richard.drennen@shieldbanking.com
(425) 249-7168

See a Demo

IN THIS ISSUE

ADVERTISER INDEX

ARIZONA BANKERS ASSOCIATION

111 West Monroe, Suite 440
Phoenix, Arizona 85003
Phone: (602) 258-1200

AZBA OFFICERS, DIRECTORS AND STAFF 2020-2021

Your Fair and Responsible Banking Program in 2021 and Beyond

By Nicholas Roesler, CRCM

This article originally appeared as the cover story in the January/February 2021 issue of ABA Bank Compliance magazine

IN THE AFTERMATH OF THE TRAGIC KILLING of George Floyd in Minneapolis, a racial justice movement has commanded society's full attention. I know I'm not alone in feeling like these events made me forget that the world was and is still facing a global pandemic. Being geographically based in Minneapolis also undoubtedly affected how these events were hitting me personally and professionally. I've asked myself, "What's next?" and "How will I be a positive vehicle for change?"

Compliance professionals who manage fair lending are depended upon to uphold a commitment to fairness that all reputable banks make to their customers, communities and employees. While building a robust, fair lending program and demonstrating compliance is not an easy task, merely avoiding unlawful credit discrimination doesn't need to be the final destination. There is always more to do, and compliance officers overseeing fair lending can provide unique and powerful viewpoints, even beyond the specific confines of Regulation B or the Fair Housing Act. Speaking at the ABA Risk and Compliance Virtual Conference in July 2020, ABA President and CEO Rob Nichols emphasized this point, saying, "when it comes to ensuring equal opportunity and access to financial products and services, you are the ones who speak up when you see something happening that isn't right. Never forget the critical role you play in making our industry stronger, safer and more equitable for all."

Disparate impact

The issues and efforts of the current racial justice movement are multifaceted and complex. One of the central themes is anti-Black racism. While much of the immediate focus surrounds police misconduct and the criminal justice system, banking is also part of the broader range of issues. Fair lending compliance practitioners are well-versed in disparate impact, which occurs when a neutral policy causes a disproportionately negative impact on a prohibited basis that is not supported by a valid business justification or necessity.

The Color of Law by Richard Rothstein describes segregation by law and public policy (i.e., government), including housing issues and the overlap with mortgage lending such as when agencies openly refused to insure mortgages for African Americans, influenced appraisal standards by including terms like "inharmonious racial groups," and created the infamous color-coded maps where neighborhoods with African Americans present were colored red, designating a neighborhood with the highest risk. There was also a downstream impact on private action segregation and redlining, such as restrictive racist covenants appearing in real estate property deeds across the country.

Despite progress through civil rights banking laws such as the Fair Housing Act and Equal Credit Opportunity Act, indicators of the lasting effects of historical redlining and discrimination remain. Black homeownership rates are almost as low now as they were when discrimination was legal. The census bureau data shows that in 1968, 41% of Black families owned their homes, while white homeownership was 66%. In the first quarter of 2020, the Black homeownership rate increased slightly to 44%, but was nearly 30% behind white households.

continued on page 6

continued from page 5

According to a report by Zillow that examined the impacts of the long-abandoned color-coded maps, the median home value in the neighborhoods that had been designated "best" had risen 230.8% to $640,238 between 1996 and 2018. In contrast, the median value in red-colored "hazardous" areas grew only 203.1%, to $276,199.

In addition to housing, legitimate race-neutral credit factors such as credit score, income, and wealth continue to show racial disparities. According to a 2019 report published by the Consumer Financial Protection Bureau, "the 2018 HMDA data shows that the credit scores of Black and Hispanic White applicants, on average, are lower than those of non-Hispanic White and Asian applicants overall and across all enhanced loan types. Additionally, there are higher percentages of Black and Hispanic White applicants whose credit scores fall on the low end of the distribution and fall below the common underwriting cutoff points."

As for wealth, the disparities are very high. A typical white family's net worth ($171,000) is nearly 10 times greater than that of the average Black family ($17,150). In a 2017 study, the Federal Reserve stated: "Wealth tends to increase with income because of higher levels of saving among higher-income families, and because of the feedback effect on higher incomes from the returns generated by accumulated assets." This same study provided findings on the income gap. It found that in 2016, median incomes for white families were $61,200, while median incomes for Black and Hispanic families were $35,400.

Independently, the disparities described above are concerning and problematic enough; when considered simultaneously and along with the lasting impacts of redlining, the interrelated and multiplying effect demonstrate a vicious cycle in desperate need of attention. In cases where the risk of unlawful credit discrimination is mitigated through a business justification, compliance officers may want to go further to review within the context of wider corporate social responsibility, conduct or ethics lens.

Special Purpose Credit Programs

Regulation B §1002.8 is dedicated to Special Purpose Credit Programs, intended to promote access to credit through lending products and programs designed to meet special social needs and benefit economically disadvantaged groups. This includes meeting the needs of a prohibited basis group that is being underserved in the market. These programs allow collecting prohibited basis characteristics, such as race, to ensure the credit programs are appropriately targeted to intended prohibited basis group applicants. While companies across various industries can make commitments through philanthropy, diversity initiatives or public statements denouncing racism, a Special Purpose Credit Program is clearly one fairness-boosting opportunity unique to the banking industry.

The basic components of a Special Purpose Credit Program include demonstrating the unmet need, drafting a written plan to lay out the specifics of how the program will operate, and engaging with whichever regulator has responsibility for overseeing Regulation B for your institution. The commentary to Regulation B clarifies that "a for-profit organization must determine that the program will benefit a class of people who would otherwise be denied credit or would receive it on less favorable terms. This determination can be based on a broad analysis using the organization's research or data from outside sources, including governmental reports and studies."

In its summer 2016 Supervisory Highlights, the CFPB set forth observations regarding credit decisions made pursuant to the terms of programs that for-profit institutions have described as Special Purpose Credit Programs. Two examples observed by the CFPB included:

- ✔ Small business lending programs providing credit to minority-owned businesses that were otherwise more likely to be denied credit than non-minority owned firms.
- ✔ Mortgage lending programs with special rates and terms for individuals with income below certain thresholds or, for those buying property in areas where the median income was below certain thresholds, which otherwise would have resulted either in denial of mortgage credit or in higher-priced mortgage credit.

The CFPB stated it "generally takes a favorable view of conscientious efforts that institutions may undertake to develop special-purpose credit programs to promote extensions of credit to any class of persons who would otherwise be denied credit or would receive it on less favorable terms."

The CFPB also recently published an article on July 31, 2020, reminding creditors of the availability and opportunity related to Special Purpose Credit Programs.

Responsible Innovation

In some ways, it's difficult for banks to make loans that meet safety and soundness standards without using commonly accepted creditworthiness factors — such as a credit score, income, net worth or collateral value — that have been historically correlated with racial groups. The use of certain types of data has been shown to have a disparate impact on Black applicants, even though these data types can still be fair-lending compliant if accompanied by a valid business necessity. Thus, the resulting outcomes of reduced access to credit for Blacks are in effect perpetuated. Regulators have encouraged responsible use of alternative data and have highlighted a "success story" involving machine learning modeling techniques which increased access to credit while still being fair.

A Special Purpose Credit Program, used in conjunction with alternative data (e.g., perhaps an alternative to using a traditional credit score), or machine learning while adding risks, complexity and uncertainty that comes from "unproven" techniques, offers an exciting possibility to explore alongside your regulators. Establishing principles regarding the ethical use of data is another action that can have a far-reaching impact, given that good use of data is foundational to responsible innovation.

Proxy Methodology: Filling a Crucial Data Void

With the intent of protecting civil rights, Regulation B prohibits a creditor from asking for, collecting, recording or otherwise retaining prohibited basis group information, except in the case of residential real estate loans or other limited cases (e.g., Special Purpose Credit Program, Self-Testing). Despite this prohibition, banks are still expected to oversee and manage fair lending risk across all credit types.

There's practically no other choice to fill the void when performing data-driven fair lending analysis of disparate treatment or disparate impact for non-mortgage products with prohibited data collection. There's practically no other choice but to rely upon a proxy to designate an applicant's race. The use of surrogates for an applicant's prohibited basis group characteristics is referenced in the long-standing interagency fair lending examination procedures. For banks regulated by the CFPB, the Bayesian improved surname geocoding or BISG, proxy method — which combines geography- and surname-based information — is most commonly used for fair lending analysis.

There is still room for some customization in how to apply a proxy to real-world situations. This makes the evaluation of your bank's proxy methodology — to ensure sound support and justification — a fair lending imperative to consider the scope of consumer and business credit products and activities. The CFPB's planned rulemaking under Section 1071 of the Dodd-Frank Act will require financial institutions to collect, report, and make public certain information concerning credit applications made by women-owned, minority-owned, and small businesses.

Exploring Mystery Shopping

Another way to root out disparate treatment is by using mystery shoppers. As a part of a 2016 joint fair lending action by CFPB and the Department of Justice, the CFPB disclosed its first use of "mystery shopping" and noted that other government agencies and housing organizations "had used

testers for decades as a method of identifying discrimination." In July 2020, a study was released by the National Community Reinvestment Coalition regarding Paycheck Protection Program loans that used matched-pair testing, and it noted past matched-pair "mystery shopper" tests were conducted by the NCRC in 2017, 2019 and earlier in 2020. The twist on this study was that mystery shopping was conducted over the phone.

ABA Resources: Diversity, Equity and Inclusion

ABA is committed to helping banks of all sizes build diverse, equitable and inclusive workplaces that best represent the communities they serve. Our members have access to training, industry-leading practices and other dedicated resources to help them achieve their DEI goals. Learn more at https://www.aba.com/banking-topics/operations/diversity-equity-inclusion.

Mystery shopping could be a useful tool to detect inconsistencies that point to potential fair lending risks related to racially correlated mistreatment. However, there are limitations, costs, scoping and administration complexities, and other uncontrolled factors that arguably diminish the conclusiveness of results with respect to unlawful credit discrimination. There are also limited examples of banking regulators using mystery shopping for fair lending examinations, appearing instead to be a supplemental investigative measure used only in extreme cases. Before considering whether mystery shopping may be an appropriate addition to your bank's fair lending program, you might find value in first exploring other ways to strengthen existing controls and oversight of pre-application risks, such as through review of branch procedures, banker interviews, branch visits, complaint monitoring and customer experience metrics.

Final Thoughts

Over the years, I've heard people say many times that compliance can be a thankless job. Let me take the opportunity to say "thank you" to all the professionals who work day-in and day-out tirelessly to achieve compliance and to do what is right. As banks continue to renew commitments and assess what more can be done to make more progress to increase fairness, let's continue to look for opportunities to strengthen our fair and responsible banking programs, as well as to take advantage of synergies with initiatives occurring among the areas of diversity, human resources, Community Reinvestment Act, ethics, conduct, innovation and corporate social responsibility.

Regulatory agencies have multiple initiatives and efforts to improve diversity, equity and inclusion, such as the CFPB's request for information on ways to prevent credit discrimination and build a more inclusive financial system. The RFI covers a lot of ground, including disparate impact, limited English proficiency, Special Purpose Credit Programs, affirmative advertising, small business lending, sexual orientation and gender identity discrimination, federal preemption of state law, treatment of public assistance income, artificial intelligence and machine learning and adverse action notices. Essentially, the CFPB asks whether it should provide additional clarity, guidance, or interpretation within the context of the Equal Credit Opportunity Act and Regulation B on these topics. This type of regulatory engagement is encouraging and highlights another opportunity for public and private sectors to work alongside one another to make positive change.

As Martin Luther King, Jr. said: "The time is always right to do what is right."

Nicholas Roesler, CRCM, is an SVP and fair and responsible banking officer at Minneapolis-based U.S. Bank. He leads the fair and responsible banking program and is responsible for overseeing and managing fair lending, UDAAP, and HMDA risk across the enterprise.

How are Businesses Addressing COVID-19 Bankruptcy Concerns?

By Peter Riggs and Kris Dekker

As we look back on what was a truly historic year, it bears noting at the outset that the disruption and suffering that so many people experienced in 2020 can hardly be overstated. The loss of life, human connection, jobs and economic opportunities was unlike anything we have seen in modern times. We should never lose sight of the human impact of this pandemic and, as we look forward to hopefully better days in 2021, we must remain mindful of the devastating effects of COVID-19 on so many people's lives.

From an exclusively economic perspective, the most significant story of 2020 was the degree to which federal stimulus was able to significantly mitigate the impact that the pandemic had on the economy. Once it became clear that COVID-19 was spreading rapidly in the United States and restrictions on person-to-person contact would be required, analysts predicted waves of commercial bankruptcies across numerous industries. Ultimately, however, while it was an active year for commercial bankruptcies, the volume of filings was substantially less than predicted, predominantly because of government stimulus, in the form of PPP and other loans, stimulus payments, and expanded unemployment benefits that helped maintain consumer spending and prevent even greater job losses.

The impact of the pandemic across different sectors of the economy was by no means uniform. Certain sectors faced devastating impacts, while others thrived. Not surprisingly, many companies were able to adapt to the pandemic using new delivery models for their products and services, some of which may continue after the pandemic.

Physical Retail

Since the emergence of online retail, physical retail (retail operating in physical locations rather than online) has declined, and the pandemic has accelerated that decline. In 2020, the pandemic-related restrictions caused physical retail to experience a significant drop in foot traffic. Compounding the problem for physical retail is that the restrictions, in many cases, pushed consumers to find online alternatives, which could very well impact consumer behavior beyond the pandemic. Notable retailers that sought bankruptcy protection in 2020 include JCPenny Co. Inc., Neiman Marcus Group Inc., Lord & Taylor, Guitar Center, Tailored Brands (including retail brands Men's Wearhouse and Jos. A. Bank), Ascena Retail (including retail brands Ann Taylor and Loft), GNC, J. Crew, Brooks Brothers, Stein Mart, Pier 1 Imports, Century 21 Department Stores LLC, True Religion and Sur La Table.

The decline in physical retail has also impacted commercial real estate. Struggling retailers became unable to pay rent, which impacted income and property values for commercial property owners. Two major mall owners filed for bankruptcy protection this past year: CBL Properties and PREIT.

Other Businesses Dependent upon Physical Presence

Some otherwise strong businesses suddenly found themselves in crisis due to a sudden shift in consumer behavior, most notably those businesses that depend on the consumer's physical presence. Several such companies sought bankruptcy protection in the fitness center space (Yoga Works and Cyc Holdings, owner of Cyc Fitness, Gold's Gym International and 24 Hour Fitness Worldwide, Inc., among others), the restaurant industry (California Pizza Kitchen; FoodFirst Global Restaurants, owner of Brio; Garden Fresh Restaurants, owner of Souplantation and Sweet Tomatoes; and CEC Entertainment, the parent company of Chuck E. Cheese, among others), and movie theater chains (Studio Movie Grill Holdings and Cinemex USA Real Estate).

The travel industry also suffered significantly from the restrictions and health concerns arising from the pandemic. While the airlines were beneficiaries of a $25 billion government bailout, other travel-related businesses such as hotels, rental cars and ride-hailing services were not as fortunate. Rental car company Hertz is the most prominent example that wound up in bankruptcy in 2020. Other downstream vendors such as VRBO and Airbnb owners also saw significantly reduced revenues on account of declines in travel overall and customer weariness associated with booking non-standardized rental units during a pandemic.

Energy

The sharp decline in personal and business travel and daily office commutes, combined with price wars in global markets, has sent oil and gas prices to historic lows and accelerated a multiyear decline for oil and gas companies in 2020. According to a recent analysis by Haynes and Boone LLP, 45 oil and gas drillers filed for bankruptcy during the first 11 months of 2020, citing some $54 billion in debts. Similarly, in the oil field service industry, 57 companies filed for bankruptcy protection during the same period, citing $41B in debts.

Bright Spots

Of course, not all segments of the economy suffered. The effects of COVID-19 have accelerated the prospects of online retailers such as Amazon, connectivity services such as Zoom, home improvement stores such as Lowes and Home Depot, home fitness equipment manufacturers such as Peloton, entertainment services such as Netflix and video game platforms, and big-box retailers such as Walmart and Target. These businesses boomed in large measure due to changes in consumer behavior resulting from pandemic-related restrictions and concerns.

What are some top concerns for business owners and employers in the realm of bankruptcy and restructuring?

While 2020 was an active year for commercial bankruptcies, the volume of filings was not as substantial as predicted in the spring. As mentioned above, this is in large part because of government stimulus. Additional recently enacted stimulus and the rollout of vaccinations give a reason for optimism in 2021, but significant uncertainty remains, and we still anticipate a further decline in the economy before any improvement.

Office real estate may become an increased area of concern in 2021. A shift to remote work in many industries may cause many businesses to reevaluate their office space needs. That could lead to reduced demand and ultimately reduced rent and property value for owners of office real estate.

Many lenders adopted a “wait and see” approach for commercial loans during 2020, with most being willing to grant deferral and forbearance agreements to their borrowers. The patience of lenders may wane, however, as non-performing loans create a drag on portfolio performance. Given that, we anticipate a moderate uptick in loan enforcement in 2021.

For business owners who are considering reorganization as a means to maintain their business operations but who have granted personal guarantees for their business’s debts, those owners will want to first confirm whether the business’s bankruptcy triggers additional liability under their personal guaranties before they undertake any action for reorganization.

What changes may be coming up (or what recent changes have taken place) due to regulations or public perceptions?

Most people believe, based on guidance from medical professionals and government officials, vaccination efforts should allow COVID-related restrictions to be eased sometime in 2021, hopefully putting many businesses that have been impacted by those restrictions back on the path to recovery, but uncertainty remains about how quickly the restrictions can be eased and how soon after that the economy will recover. We have at least some clarity about what to expect concerning that timeline. This greater clarity should help businesses plan and provide banks greater comfort in extending bridge financing, maturity extensions, and forbearances to their customers, enabling those customers to get through the remainder of the pandemic. Greater certainty should arrive as the vaccination efforts continue over the coming months and the public health picture comes into clearer focus.

Despite our anticipation that pandemic restrictions are likely to ease during 2021, some economists still believe there may be a surge in commercial bankruptcies at some point this year as government stimulus tapers off. While additional government stimulus is still planned, some think it may be ultimately insufficient to keep many businesses from filing for bankruptcy, raising concern about whether there will be sufficient judicial bankruptcy resources and debtor-in-possession financing for small businesses.[1] If a bankruptcy surge of significant magnitude begins to emerge, the government may address these concerns, but additional legislative reform is unlikely at present.

Is the need for bankruptcy relief being exacerbated by COVID-19?

While the pandemic has certainly put an economic strain on many businesses, most notably those relying on the physical presence of customers, such as hospitality, restaurants, retail, and theaters, the unprecedented economic stimulus injected by the government in 2020 appears not only to have staved off any increase in commercial bankruptcies but perhaps actually decreased them, at least for the time being, relative to historical levels. Through November of last year, 30,310 commercial bankruptcies were filed in the U.S. Assuming a uniform monthly pace of filings, that would result in approximately 33,065 filings for 2020. By comparison, in 2017, 2018 and 2019, there were 39,050, 38,044 and 38,536 commercial bankruptcies filed, respectively.[2] 2020 saw an increase in Chapter 11 filings, with the largest number of commercial cases filed (6,735 through November 2020) since 2012 (7,289 Chapter 11 cases).[3]

Looking forward, both government parties seem intent on extending additional stimulus as we move through 2021 in a continued effort to save businesses and jobs, and the vaccination efforts provide a real reason

continued on page 10

continued from page 9

to believe that COVID-related restrictions could be eased at some point this year. Because of those developments, there is optimism that COVID will not ultimately force significantly greater numbers of companies into bankruptcy than would have otherwise filed without the impacts of COVID.

That said, undoubtedly, many companies have merely survived the pandemic thus far and have depleted cash reserves and other capital to do so. Once that capital is spent and government stimulus tapers off, these companies may need to consider bankruptcy.

There also are businesses that may not absorb the full impact of the pandemic for several years yet. For instance, if companies ultimately find work-from-home arrangements to be economical, effective and popular on a long-term basis to the degree that allows them to reduce their office footprints, the office landlords may not feel the impact of that reduced demand until the leases begin to expire. And some businesses may never return to their pre-COVID revenues because their customers' preferences may have changed during the pandemic, such as consumers who acquired a new-found preference for online delivery and curbside services, all of which could lead to additional bankruptcies long after the COVID virus has been contained.

How might businesses position themselves for the best outcomes? Are there alternatives?

Be proactive. Every business should evaluate what it needs to sustain its operations through the end of the COVID-related restrictions. In connection with that, businesses will want to consider whether their industry is likely to recover quickly or more slowly once those restrictions are eased. Once the company's capital needs are reasonably determined (understanding, of course, that uncertainty still exists regarding just how long it will be until those restrictions are eased and the economy returns to pre-COVID strength), it should identify its sources of potential capital. For many small businesses, this capital source will primarily be its lender. Businesses should engage in conversations with their lenders as early as possible. So far, government stimulus and a desire to maintain customer relationships have encouraged most banks to be liberal when granting their borrowers some form of payment deferral when requested. When justified, banks have also agreed to restructure long-term debt, understanding that the pandemic will eventually come to an end while still causing immediate economic strain.

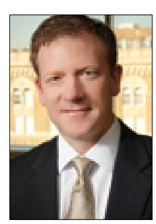
Look to your bank for advice. Some banks have become a source of credit to their customers and a growing resource of business information, even offering classes and workshops covering finance, management and leadership, sales and marketing, human resources, and information technologies. Most banks will provide their business customers with the latest information regarding COVID-specific lending programs, such as the Paycheck Protection Program and Economic Injury Disaster Loans that were previously enacted by Congress. Because the government appears committed to extending additional COVID-specific stimulus programs throughout 2021, forming a good relationship with your lender will position you well to take advantage of these programs as they become available.

Businesses that are suffering from COVID-related restrictions may also want to consider whether they can adapt their operations to help mitigate the impacts of COVID. Many companies in the restaurant, retail, and grocery industries have successfully implemented new delivery and curbside services. In some cases, these new services have been so successful that business owners will likely consider continuing these services after the pandemic is over.

Unfortunately, businesses that the pandemic has significantly impacted may need to consider bankruptcy. In some circumstances, this may mean winding down operations and liquidating. In other circumstances, this could mean reorganization, which entails obtaining some form of debt relief but results in the business operation continuing rather than winding down. Concerning reorganizations, in 2019, Congress enacted the Small Business Reorganization Act of 2019, creating a faster and more efficient reorganization option for small business debtors. Originally, this option was available only to businesses with debt not exceeding $2,725,625. In reaction to the economic fallout from the COVID pandemic, Congress expanded this option, making it temporarily available through March 27, 2021, to businesses with debts up to $7,500,000. For small businesses in need of debt relief, reorganization under the Small Business Reorganization Act is a far more viable option from a cost and efficiency standpoint than the standard Chapter 11 bankruptcy, which was previously the only option available for reorganization. This new reorganization option aims to allow more small businesses an opportunity to remain in operation.

1 https://www.brookings.edu/wp-content/uploads/2020/09/Greenwood-et-al-conference-draft.pdf
2 https://www.abi.org/newsroom/bankruptcy-statistics
3 Id.

Peter Riggs is a partner at Spencer Fane LLP in the firm's Kansas City office. He is an experienced litigator and regulatory attorney who advises clients across the financial services industry in litigation, government and internal investigations, and bankruptcy and creditors' rights matters.



Kris Dekker is a partner at Spencer Fane LLP in the firm's Kansas City office. He helps banks, financial institutions and other lenders of varying sizes close their transactions efficiently, representing them in all phases of lending.

The Arizona Statute of Limitations Applicable to Collection Lawsuits and Non-Judicial Trustee's Foreclosure Sales of Real Property

By Larry O. Folk, Folks Hess PLLC

THE GREAT RECESSION CAUSED AN alarming decline in both the Arizona real estate market and many borrowers' and guarantors' financial positions. One effect was that, for years, many lenders elected not to pursue collection of eligible defaulted loans through:

- Collection lawsuits based upon credit card agreements and promissory notes ("Collection Lawsuits"); and
- Non-judicial trustee's foreclosure sales of real property based upon mortgage loan promissory notes and deeds of trust ("Foreclosure Sales").

As time has passed since the Great Recession, both the Arizona real estate market and the financial position of many previously distressed borrowers and guarantors have improved significantly. That has resulted in lenders deciding to pursue Collection Lawsuits and Foreclosure Sales based upon loans that have been in payment default or fully matured for years.

COVID-19 is now causing an even further delay of lenders exercising their collection rights and remedies concerning many defaulted loans due to a new recession in Arizona and moratoriums imposed by the federal government against lenders conducting certain Foreclosure Sales.

Regardless of the reason for the lender's delay in collecting upon a dormant defaulted loan, borrowers and guarantors are quick to assert the affirmative defense of the Arizona statute of limitations as a bar against the lender pursuing the long-delayed Collection Lawsuit or Foreclosure Sale. Although many of the Collection Lawsuits and Foreclosure Sales are, in fact, now time-barred by the Arizona statute of limitations, the analysis to determine whether or not the statute of limitations applies is complex.

To assist in deciding whether or not the statute of limitations bars a Collection Lawsuit or Foreclosure Sale, we have prepared the following list of frequently asked questions ("FAQs") that our firm often receives. Our responses to the FAQs:

- Are limited to an analysis of current Arizona law,
- Do not take into account arguments that may be made with respect to the tolling of the statute of limitations as a result of the federal COVID-19 moratoriums or for other reasons, and
- Are not intended to be a substitute for independent legal research and analysis when making the ultimate decision to pursue collection of a given defaulted loan.

1. What is the Arizona statute of limitations that applies to collecting on a defaulted promissory note or credit card agreement?

Short answer: Six years.

The Arizona statute of limitations applicable to a lender's breach of contract cause of action based upon a defaulted promissory note or a credit card agreement is six years. A.R.S. § 12-548 sets forth said applicable six-year statute of limitations as follows:

12-548. Contract in writing for debt; six-year limitation; choice of law.

A. An action for debt shall be commenced and prosecuted within six years after the cause of action accrues, and not afterward, if the indebtedness is evidenced by or founded on either of the following:

1. A contract in writing that is executed in this state.
2. A credit card as defined in section 13-2101, paragraph 3, subdivision (a).

2. Does the same six-year statute of limitations apply to a non-judicial trustee's Foreclosure Sale of real property?

Short answer: Yes.

In February 2018, the Arizona Court of Appeals held that the six-year limitations

continued on page 12

continued from page 11

period of A.R.S. § 12-548(A)(1) applies equally to bar a lawsuit to collect upon an unsecured promissory note and conducting a non-judicial Foreclosure Sale. Refer to Andra R. Miller Designs LLC v. US Bank, 244 Ariz. 265, 269, 418 P.3d 1038, 1042 (AZ Ct. App. 2018), review denied (July 3, 2018).

3. Can a lender collect upon a promissory note that matured six or more years ago?

Short answer: No.

The statute of limitations applies to each matured/defaulted note installment payment separately as it becomes due under the note amortization schedule, and it does not begin to run on any installment until it is due. Refer to Andra R. Miller Designs LLC v. US Bank NA, 244 Ariz. 265, 270, 418 P.3d 1038, 1043 (App. 2018), review denied (July 3, 2018). See also, Ancala Holdings L.L.C. v. Price, 220 Fed. App. 569, 572 (9th Cir. 2007) (a cause of action "accrues" each time a party fails to perform as required by the contract) and Ortiz v. Trinity Fin. Servs. LLC, 98 F.Supp. 3d 1037, 1042 (D. Ariz. 2015) (each time the debtor fails to make a payment when it becomes due, a separate breach occurs and a cause of action "accrues," starting the clock).

Because the maturity date of a promissory note is the last scheduled installment payment of the debt instrument, the cause of action for that final installment payment "accrues" on the loan maturity date. As a result, a lender cannot sue upon the promissory note six years or more after the scheduled maturity date.

EXAMPLE: Loan Maturity Date: 1/1/2015. Current Date: 1/2/2021. A Collection Lawsuit or Foreclosure Sale is barred, as more than six years have passed since the loan maturity date.

4. When does a cause of action "accrue" upon a defaulted credit card agreement loan for the purpose of calculating the six-year statute of limitation?

Short answer: On the date of the first uncured missed payment upon the credit card loan.

The Arizona Supreme Court, in Mertola v. Santos, 244 Ariz. 488, 489, 796 Ariz. Adv. Rep. 16, 422 P.3d 1028, 1029 (2018) held that whether or not a credit card lender exercises an optional acceleration clause in a defaulted credit card agreement, the cause of action to collect the entire credit card balance due "accrues" as of the date of the first uncured missed payment.

EXAMPLE: Last Payment On Credit Card: 1/1/2015. Current Date: 1/2/2021. Collection Lawsuit based upon the credit card agreement is barred.

5. Are there different rules to determine when a cause of action "accrues" for applying the six-year statute of limitations concerning a suit on an installment promissory note versus a credit card agreement?

Short answer: Yes. They are discussed below.

6. Application of the six-year statute of limitations to accelerated loans: When does a cause of action "accrue" upon a defaulted un-matured installment promissory note for the purpose of calculating the six-year statute of limitation if the lender has taken an affirmative act to accelerate the loan?

Short answer: The cause of action "accrues" on the date that the lender takes an affirmative act to exercise the option to accelerate the debt.

When a creditor has the power to accelerate an installment contract debt, the six-year statute of limitations begins to run on the date that the creditor takes an affirmative act to exercise the option to accelerate the debt. Refer to Mertola v. Santos, 244 Ariz. 488, 491, 796 Ariz. Adv. Rep. 16, 422 P.3d 1028, 1031 (2018) citing Navy Federal Credit Union v. Jones, 187 Ariz. 493, 495, 930 P.2d 1007, 1009 (AZ App. 1996) ("[I]f the acceleration clause in a debt payable in installments is optional, a cause of action as to future non-delinquent installments does not 'accrue' until the creditor chooses to take advantage of the clause and accelerate the balance"). In addition, the creditor must undertake some affirmative act to make clear to the debtor that the debt has been accelerated. Id. See also, Baseline Financial Services v. Madison, 229 Ariz. 543, 544, 78 P.3d 321, 322 (AZ App. 2012) ("when an installment contract contains an optional acceleration clause, an action as to future installments does not 'accrue' until the holder exercises the option to accelerate").

EXAMPLE: Loan Date: 1/1/2010. Loan Maturity Date: 1/1/2040. Loan Acceleration Date: 1/1/2021. A Collection Lawsuit or Foreclosure Sale may be initiated within six years after the acceleration date — until 1/1/2027.

7. Application of the six-year statute of limitations to loans that have not been accelerated: When does a cause of action "accrue" upon a defaulted un-matured installment promissory note for the purpose of calculating the six-year statute of limitation if the lender has not taken an affirmative act to accelerate the loan?

Short answer: The statute of limitations applies to each matured/defaulted Note installment payment separately. It becomes due under the Note amortization schedule and does not begin to run on any installment until it is due.

If the creditor does not exercise the option to accelerate an installment contract debt and/or to determine the date of "accrual" of a cause of action upon a matured/defaulted monthly installment payment, the statute of limitations applies to each matured/defaulted Note installment payment separately as it becomes due under the Note amortization schedule, and does not begin to run on any installment until it is due. Refer to Andra R. Miller Designs LLC v. US Bank NA, 244

Ariz. 265, 270, 418 P.3d 1038, 1043 (App. 2018,) review denied (July 3, 2018). See also, Ancala Holdings L.L.C. v. Price, 220 Fed. App. 569, 572 (9th Cir. 2007) (a cause of action "accrues" each time a party fails to perform as required by the contract) and Ortiz v. Trinity Fin. Servs. LLC, 98 F.Supp. 3d 1037, 1042 (D. Ariz. 2015) (each time the debtor fails to make a payment when it becomes due, a separate breach occurs and a cause of action "accrues," starting the clock).

The rules discussed above concerning determining the date of "accrual" of a cause of action based upon a defaulted mortgage loan installment promissory note have been applied consistently by the Arizona Court of Appeals and the United States District Court for the District Of Arizona in the following line of cases: Andra R. Miller Designs LLC v. US Bank NA, 244 Ariz. 265, 418 P.3d 1038 (AZ App. 2018), review denied (July 3, 2018). Baseline Financial Services v. Madison, 229 Ariz. 543, 278 P.3d 321 (AZ App. 2012); Navy Federal Credit Union v. Jones, 187 Ariz. 493, 930 P.2d 1007 (AZ App. 1996); Hummel v. Rushmore Loan Management LLC, 2018 WL 3744858 (D. AZ 2018); and Ortiz v. Trinity Financial Services LLC, 98 F.Supp. 3d 1037 (D. AZ. 2015). Furthermore, as was fully discussed above, the Arizona Supreme Court, in Mertola, LLC v. Santos, 244 Ariz. 488, 490, 796 Ariz. Adv. Rep. 16, 422 P.3d 1028, 1030 (2018) distinguished installment debt from credit card debt in the context of selecting the correct rules to determine when a cause of action "accrues" to calculate the six-year statute of limitation.

EXAMPLE #1: Loan Maturity Date: 1/1/2021. Last Payment: 1/1/2015. Current Date: 1/2/2021. Both a Collection Lawsuit and a Foreclosure Sale are barred.

EXAMPLE #2: Loan Date: 1/1/2010. Loan Maturity Date: 1/1/2040. Loan is not accelerated. Last Payment Made: 1/1/2015. Current Date: 1/2/2021. The limitations period bars a suit on any payments due under the loan on 1/1/2015 or earlier. The lender may, however, still commence a Collection Lawsuit or Foreclosure Sale based upon the installment payments owing from 2/1/2015 going forward.

8. Do the same rules apply to determine when a cause of action "accrues" to pursue a non-judicial Foreclosure Sale of real property as apply to a matured or un-matured installment promissory note?

Short answer: Yes.

See, Andra R. Miller Designs LLC v. US Bank, 244 Ariz. 265, 269, 418 P.3d 1038, 1042 (AZ Ct. App. 2018), review denied (July 3, 2018).

9. What qualifies as an affirmative act to accelerate an un-matured installment promissory note?

Short answer: Typically, sending a Notice of Acceleration or Demand Letter or recording a Notice of Trustee's Sale makes

continued on page 14

continued from page 13

it clear to the borrower that the lender has accelerated the loan. Also, filing a judicial foreclosure complaint is an affirmative act of acceleration of a loan.

On Jan. 14, 2021, the Arizona Court of Appeals held "that absent an express statement of acceleration in the notice of trustee's sale, or other evidence of an intent to accelerate, recording a notice of trustee's sale, by itself, does not accelerate a debt." Bridges v. Nationstar Mortgage, L.L.C., 2021 WL 126562 (AZ App. 2021). See also, Base-line Financial Services v. Madison, 229 Ariz. 543, 545, 275 P.3d 321, 323 (AZ App. 2012) (even if a contract permits acceleration of a loan without notice, the lender must perform an unequivocal act demonstrating it has exercised the loan acceleration clause); and Andra Miller Designs LLC v. US Bank NA, 244 Ariz. 265, 270, 418 P.3d 1038, 1043 (AZ App. 2018), review denied (July 3, 2018) ("to exercise its option to accelerate a debt, the creditor must undertake some affirmative act to make clear to the debtor it has accelerated the obligation").

10. Does recordation of a Notice of Trustee's Sale by itself serve as an act to accelerate an un-matured installment promissory note?

Short answer: No. The simple act of recording a Notice of Trustee's Sale, by itself, is not an affirmative act to accelerate the loan. The loan must be accelerated in writing by a separate notice of acceleration or by including language in the Notice of Trustee's Sale that the loan has been accelerated.

On Jan. 14, 2021, the Arizona Court of Appeals held "that absent an express statement of acceleration in the notice of trustee's sale, or other evidence of an intent to accelerate, recording a notice of trustee's sale, by itself, does not accelerate a debt." Bridges v. Nationstar Mortgage, L.L.C., 2021 WL 126562 (AZ App. 2021).

11. Can a lender de-accelerate a loan for the purpose of application of the statute of limitations?

Short answer: Yes. The lender can de-accelerate a loan by stating in writing that the acceleration of the debt is withdrawn or revoked.

See, Andra Miller Designs LLC v. US Bank NA, 244 Ariz. 265, 271, 418 P.3d 1038, 1044 (AZ App. 2018), review denied (July 3, 2018).

12. Does the act of a lender internally "charging off" a loan have any implication concerning whether or not an installment loan evidenced by a promissory note has been accelerated for the purpose of calculating the statute of limitations?

Short answer: No. "Charging-off" a loan is an internal bank accounting measure. It is not an affirmative act to exercise the optional acceleration clause of a loan.

See, Baseline Financial Services v. Madison, 229 Ariz. 543, 545, 275 P.3d 321, 323 (AZ App. 2012) (charge-off of a loan is an "accounting procedure within the bank" and not an affirmative exercise of the optional acceleration clause).

13. What is the statute of limitations applicable to a defaulted contract for sale, such as a retail installment contract for the sale of a motor vehicle?

Short answer: Four years.

A.R.S. §47-2725(A) of the Arizona Uniform Commercial Code ("UCC") imposes a four-year statute of limitations for suits based upon a defaulted contract for sale, which typically concerns a retail installment contract for the sale of a motor vehicle. Baseline Financial Services v. Madison, 229 Ariz. 543, 544, 275 P.3d 321, 322 (AZ App. 2012).

Additionally, a lender's repossession of a motor vehicle is an affirmative act sufficient to exercise the optional acceleration

clause of a retail installment sales contract concerning the sale of a motor vehicle. Id. at 546 and 324 citing Wheel Estate Corp. v. Webb, 139 Ariz. 506, 508, 679 P.2d 529, 531 (AZ App. 1983).

14. What is the statute of limitations that applies to a mortgage deficiency lawsuit following a lender's non-judicial trustee's foreclosure sale of real property?

Short answer: 90 days.

A.R.S. §33-814(A) and (D) require that a creditor commence an action to recover a mortgage deficiency within ninety (90) days after the date of the non-judicial trustee's foreclosure sale of the subject real property. Failure to file a deficiency lawsuit within the 90-day period results in the proceeds of the sale, regardless of amount, being deemed to be full satisfaction of the obligation and no right to recover a deficiency in any action shall exist. Furthermore, this statute of limitation is a statute of repose, meaning that it is an absolute bar date against filing a mortgage deficiency lawsuit after the 90-day post-foreclosure sale period expires. In re Wright, 486 B.R. 491, 502 (Bankr. AZ 2012) citing Resolution Trust Corporation v. Olson, 768 F. Supp. 283 (D. Ariz. 1991).

Larry Folks
Folks Hess, PLLC
1850 N. Central Ave., Suite 1140 Phoenix, Arizona 85004
602-256-5906 (direct line)
folks@folkshess.com
www.AzDefaultLegalServices.com

The National Defense Authorization Act: BSA/AML Initiatives

By Elizabeth K. Madlem, Vice President of Compliance Operations and Deputy General Counsel

ON JAN. 1, 2021, THE SENATE VOTED TO override President Trump's veto on the National Defense Authorization Act (NDAA or Act). It was previously overridden by the House back on Dec. 28, 2020. The NDAA included over 200 pages of significant reforms to the Bank Secrecy Act (BSA) and other anti-money laundering (AML) laws, putting forth the most comprehensive set of BSA/AML reforms since the USA PATRIOT Act of 2001. The continuing question is, what are the implications of this Act? How will this impact not only financial institutions but also U.S. companies and companies doing business in the United States at large?

For starters, certain U.S. companies and companies doing business in the U.S. ("reporting companies") will be required to provide FinCEN with information regarding their beneficial owners. This includes names, addresses, dates of birth, and unique identifying numbers. Newly incorporated companies will be required to do so at the time of incorporation. Exempt companies include public companies, as well as companies that: (i) have more than 20 full-time employees, (ii) report more than $5 million in yearly revenue to the Internal Revenue Service, and (iii) have an operating presence at a physical office within the United States. Changes in beneficial ownership will require reporting companies to provide FinCEN with updated information within a year. FinCEN has stated it will maintain a registry of this beneficial ownership information, but it will not be public. However, this does not prevent FinCEN from sharing this information with federal, state, local and tribal law enforcement agencies if there is appropriate court approval. FinCEN can also share the beneficial ownership information with financial institutions for customer due diligence purposes, but only with the reporting company's consent.

Second, this NDAA creates a new whistleblower program and establishes a private right of action for whistleblowers who have experienced retaliation. Aiming to incentivize reporting of BSA/AML violations, this program will award whistleblowers who give tips with as much as 30% of the monetary penalties assessed against the company if it leads to monetary penalties in excess of $1 million. This will depend on the significance of the information, the degree of assistance provided, and the government's interest in deterring BSA violations through these awards. Additionally, a private right of action for whistleblowers who suffer retaliation will be available — whistleblowers can file complaints with the Occupational Safety and Health Administration (OSHA), where, if OSHA fails to issue a decision within 180-days, the whistleblower will be free to file a claim in federal district court.

Third, the Act considerably increases the penalties for BSA/AML violations for both companies and individuals. For repeat violations, additional civil penalties of either (i) three times the profit gained or loss avoided (if practicable to calculate) or (ii) two times the otherwise applicable maximum penalty for the violation are now in play. A new BSA provision will allow for fines "equal to the profit gained by such person by reason" of the violation. It will also include bonuses paid out the year in which the violation occurred or the following year for financial institution

continued on page 16

continued from page 15

directors and employees. Those who have been determined to have engaged in "egregious" violations of BSA/AML provisions may even be barred from serving on the board of directors of a U.S. financial institution for 10 years from the date of the conviction or judgment. Lastly, the Justice Department will, for the next five years, submit reports to Congress on the use of non-prosecution and deferred prosecution agreements during BSA/AML concerns.

Fourth, the NDAA will also require the Treasury, in conjunction with the Justice Department and other agencies, to evaluate how it plans to streamline SAR and CTR requirements, thresholds and processes. Within one year of the NDAA's enactment, the Treasury must propose regulations to Congress to reduce burdensome requirements and adjustment thresholds accordingly, with the expectation of these threshold adjustments taking place once every five years, for the next 10 years.

Fifth, the Act highlights the importance of law enforcement's involvement with international AML issues. FinCEN's mission requires working with foreign law enforcement authorities to safeguard the U.S.'s financial system. To assist, the Treasury will be required to establish a Treasury Attachés program at U.S. embassies abroad and work with international organizations including the Financial Action Task Force, International Monetary Fund, and Organization for Economic Cooperation and Development to promote global AML frameworks. Additionally, FinCEN will appoint Foreign Financial Intelligence Unit Liaisons at U.S. embassies to engage with their foreign counterparts. Over $60 million per year has been allocated between 2020 and 2024 to the Treasury to provide technical assistance to foreign countries, promoting compliance with international standards and best practices for establishing effective AML and counter-terrorist financing (CTF) programs.

Additionally, the NDAA expands financial institutions' ability to share SARs with foreign branches, subsidiaries and affiliates, and requires the Treasury and FinCEN Secretary to create a pilot program to achieve this objective. Currently, financial institutions are only permitted to disclose SARs to foreign affiliates that are a "head office" or "controlling company." This has posed as a roadblock for enterprise-wide compliance within global banks. It is important to note that the Act does prohibit participants in this pilot program from sharing SARs with branches, subsidiaries and affiliates in China, Russia, and other specific jurisdictions.

Lastly, the NDAA significantly modifies the U.S. BSA/AML program in the following areas:

- Introduces several studies relating to (i) artificial intelligence, blockchain and other emerging technologies; (ii) beneficial ownership reporting requirements; (iii) trade-based money laundering; and (iv) money laundering by the People's Republic of China.
- Modifies various definitions relative to virtual currencies and other nontraditional cash substitutes;
- Introduces antiquities dealers (but not art dealers) to BSA's applicable scope;
- Expands ability to subpoena foreign banks' records that maintain correspondent accounts in the U.S.;
- Creates a "FinCEN Exchange" to oversee voluntary public-private information sharing between law enforcement, national security agencies and financial institutions; and
- Envisions a no-action letter process for FinCEN.

Apart from these topics, the NDAA reincorporates an emphasis on risk-based approaches to AML program requirements and discusses prior proposed rulemaking from FinCEN. It even includes discussions on the Treasury being required to periodically publish on national AML and CTF initiatives.

There is no doubt that the NDAA's initiatives will be extended over several years and require continued efforts by public and private sectors. The cost of these initiatives to the financial industry and small businesses has yet to be determined and remains a cry of protest from those against the reform. But this does appear to be the start of a more globally-centric effort to combat financial terrorism and money laundering crimes.

Elizabeth is the Vice President of Compliance Operations and Deputy General Counsel at Compliance Alliance. In the past, she served as both the Operations Compliance Manager and Enterprise Risk Manager for Washington Federal Bank, a $16 billion dollar organization headquartered in Seattle, Washington.

She has industry expertise and real-world solutions surrounding bank-enterprise initiatives and knowledge of contract law and bank regulatory compliance. An attorney since 2010, Elizabeth was a Summa Cum Laude, Phi Beta Kappa, Delta Epsilon Sigma graduate of Saint Michael's College in Burlington, Vermont, and a Juris Doctor from Valparaiso University School of Law in Indiana.

As the Vice President of Compliance Operations, Elizabeth oversees C/A's day-to-day operations of the Hotline, as well as leading our Education initiatives. Elizabeth plays an important part in all operational areas of C/A.

Relationship Value Pricing and Customer Profitability

By Jay Kenney, SVP & Southwest Regional Manager for PCBB

RELATIONSHIP VALUE PRICING CAN be an effective strategy for improving a community bank's fee income and determining the overall customer relationship's worth. This is especially important in the current interest-rate environment.

However, for relationship value pricing to work, your institution must carefully analyze each customer relationship's costs and profitability, have systems that monitor the relationship, and think creatively about what it can offer preferred customers.

Defining Relationship Pricing

In relationship pricing, a community bank adjusts fees and rates for a deal based on the overall relationship with the customer and their related parties. This links the value of the deal to the profits of the institution.

Typically, this means you can structure deals for products or services that make sense for the institution and the customer. For instance, by adding an operating account that generates transactional fee income, the lender can offer a more competitive rate on a loan and still meet the same ROA/ROE or lifetime income. Sometimes bankers are asked to increase the rate they're paying on a money market account, CD, or a credit product for a client. But a client relationship is more than a single rate — it's the total value that the relationship brings to the table.

Provide Creative Customer Offerings.

Rather than negotiate solely over rates, talk to your customers about what they value. Are they willing to move their operating account or excess deposits? Would they consider trading fees for interest rates? Or are they interested in different structures? Knowing this increases their value to you as a customer and your ability to compete and close deals.

Some useful and innovative options could include:

- **Ask for the deposit.** Some customers are awash in cash these days, while others are cash strapped. By asking for their operating accounts, you can help your institution reduce its overall cost of funds while increasing the relationship's stickiness.
- **Look for fee income.** Some business owners may need a little extra help these days and would even be willing to pay for it. Consider your natural prepayment rate and prepayment penalties for longer-term obligations or increasing fees for longer fixed-rate terms.
- **Consider different structures.** Term may matter. Is it fixed or floating, and when are rates reset? How are you setting up payments? Could you be creative, meet lifetime income thresholds, and match your borrower's seasonal cashflows?

Take a holistic view. Once you have solved some of your customers' problems, be sure to look at the entire customer relationship. It is not just about one product vs. three products, either. Sometimes, you have customers with three loans that don't add as much value as the customers with one loan. By analyzing the whole customer relationship, including grouping customers by their related accounts, you can provide additional services or discounts based on the total relationship profitability, not just the number of products used. To assess properly and efficiently, profitability modeling is recommended. You get an objective view and can drill down into the data, making it easy to adjust offerings, as needed.

If you need assistance with relationship value pricing or customer profitability, please contact Jay Kenney.

Jay Kenney
SVP and Southwest Regional Manager for PCBB
pcbb.com | jkenney@pcbb.com

Dedicated to serving the needs of community banks, PCBB's comprehensive and robust set of solutions includes cash management, international services, lending solutions and risk management advisory services.

CCG Catalyst Consulting, Arizona Bankers Association Announce the Arizona Fintech Council

The new initiative will connect fintechs across the world with U.S. financial institutions to drive product and service innovation.

CCG CATALYST CONSULTING (CCG CATALYST) AND THE ARIZONA BANKERS ASSOCIATION (AzBA) have partnered to create the Arizona Fintech Council (AZFC) to spur economic growth in the state and bring viable and promising fintech companies to Arizona's Fintech Sandbox.

> **"The unique nature of our state's fintech sandbox law and our relationship with the national consultancy of CCG Catalyst put us in a position to maximize this economic development opportunity to bring these transformational companies to Arizona."**

The council will initiate new opportunities for member financial institutions and selected fintechs to connect, evaluate startups' readiness to work hand in hand with financial institutions on innovative new products and services, and aid in arranging proofs of concept (PoCs) with participating financial institutions and fintechs in Arizona's regulatory sandbox.

"The unique nature of our state's fintech sandbox law and our relationship with the national consultancy of CCG Catalyst put us in a position to maximize this economic development opportunity to bring these transformational companies to Arizona," said Paul Hickman, president and chief executive officer (CEO) at the Arizona Bankers Association.

The Fintech Council and the Arizona Sandbox are unique given there are no domicile restrictions on the financial institutions or fintech applicants. The Arizona Fintech Sandbox eases regulatory burdens for fintechs while allowing them to partner with financial institutions testing innovative products and services. It is a great opportunity for new entrants, whether it be startups or established companies new to the U.S. marketplace. Participating financial institutions can enter prospective partnerships with, invest in or outright acquire participating fintech companies. Participants will include diverse institutions of the AzBA, including member financial institutions of all sizes, ranging from community, regional, super-regional and financial institutions with more than $1 trillion in assets. Select institutions that are not AzBA Association members may also participate, and other stakeholders from government and academia will also join the council's ranks.

Leading Arizona organizations, including the Arizona Commerce Authority (ACA), Arizona Technology Council (AZTC), Greater Phoenix Economic Council (GPEC) and Sun Corridor, Inc. (SCI), will also work to entice fintechs to come to the state and help them partner with financial institutions.

"Under Governor Ducey's leadership, Arizona was the first state in the nation to establish a fintech sandbox program, demonstrating our commitment to embracing the emerging technologies that will shape our future," said Sandra Watson, Arizona Commerce Authority President & CEO. "The Arizona Fintech Council will further advance our state's reputation as a hub for innovation in the financial services industry, and the ACA is proud to participate in the effort alongside partners statewide.

Arizona State University (ASU) will also partner with the Council to make connections for its students interested in the financial services industry. Ranked No. 1 in innovation by U.S. News & World Report for the sixth year running, ASU offers a strong talent pool and will be an asset for new and emerging fintechs looking for further growth and expansion.

"At Arizona State University, we are always looking at data that informs us about what is ahead in workforce development and preparing students for jobs that may not even yet exist," said ASU President Michael M. Crow. "The plans for advancement and the work that will be done through the Arizona Fintech Council is exciting because of what it can do to help companies prepare, and new companies emerge, to meet the opportunities ahead and the kind of talent and skills needed to drive successful outcomes. Cultivating a mindset of transformation helps growing areas of our economy, such as fintech, prosper, and we look forward to working together."

The Council will facilitate connections through regular summits, where fintechs selected with CCG's Catalyst recommendation will showcase their ideas to member financial institutions. If a member institution seeks to partner with one of the presenting startups on a PoC, the Council will refer an application to the Arizona attorney general for approval and inclusion in the sandbox program.

As a leading bank and fintech consulting firm, CCG Catalyst advises our clients on strategy related to financial services and the fusion of banking and fintech. Bringing this partnership together with AzBA and enlisting the support of numerous financial institutions, regulatory agencies, and public innovators such as ASU, ACA, GPEC, SCI and AZTC will bring new opportunities to the financial services community locally and across the nation, said Paul Schaus, president and CEO of CCG Catalyst. Scarlett Sieber, CCG Catalyst's chief strategy and innovation officer, will lead the fintech effort. Miranda Jenkins, the firm's chief operating officer, will manage the fintech program. The combination of banking and fintech is a natural progression within the industry, and CCG Catalyst is excited to be part of this evolution.

About CCG Catalyst Consulting
CCG Catalyst is a global management consulting firm specialized across the financial services industry. We advise our banking and fintech clients on the direction and future of the industry. Leaning on our wealth of experience and proven track record of delivery, we bring continuous innovation to support our clients, improve their performance and create lasting value across organizations. For more information, visit www.ccgcatalyst.com and follow us on Twitter @CCGCatalyst and LinkedIn.

About the Arizona Bankers Association
AzBA is the 117-year-old trade association for Arizona's community banks and financial services industry. The association represents banks taking deposits statewide, from Yuma to Tuba City and all points in between. For more information, visit https://azbankers.org/ and follow us on Twitter @azbankers and LinkedIn.

Capturing These Three Data Types Can Transform Your Fraud Monitoring

By Matthew Van Buskirk

This article originally appeared in the American Bankers Association Magazine

WHEN WE THINK OF THE WORK done by anti-fraud and AML teams, we automatically view it from the bank's perspective. We know that bad actors are trying to commit fraud and launder money through the financial industry, and we take steps to stop it. We think in terms of how much it costs to keep the bad guys out.

But we rarely think about this from the bad guys' perspective and how much it costs them to get in. Viewing things through their eyes is the key to understanding how to design modern AML programs — don't try to block them outright. Instead, make it too expensive for them to bother trying.

Bad actors are changing their tactics quickly, and keeping up is difficult for banks.

Compromised Data and Synthetic Identities

Security firm Norton reported that 4.1 billion consumer records were compromised in 2019. We have reached a point where a fraudster may be more likely to pass standard KYC/CIP checks than a legitimate customer. This is possible because the fraudster can buy a full set of compromised identity data on the dark web and enter completely accurate customer information when signing up for an account. Since that information is entered via a script, the fraudster won't make any mistakes where a real person may fat finger a digit in their Social Security number.

Compromised data sets are bad, but there is still a chance that the consumer will notice unexplained accounts on their credit report. Synthetic identities remove that risk for the bad actor. The FTC identified synthetic fraud as the fastest growing form of fraud in the U.S.

This approach is even harder to detect since the identities are manufactured to appear real. Bad actors combine pieces of different individuals' personal information into a synthetic persona, then patiently build a history for that persona, often including financial accounts, on-time loan payments and an online social media presence. In the fraud context, the bad actors are looking to build trust to allow access to large credit lines before "busting out" and disappearing. Most of the focus on synthetic identities is on their potential for fraud. Still, the more nefarious use case may be in money laundering, where the manufactured identity keeps operating normally with no fraud occurring.

If the only tools at the banks' disposal are credit checks, validation of CIP data fields, and rules-based transaction monitoring, it will be nigh-on impossible to differentiate between the good customers and the wolves in sheep's clothing.

So, how should a bank deal with these evolving threats?

In short, look to capabilities developed in the fintech space that center on gathering data beyond the scope of traditional KYC/AML programs.

In a fintech firm, the customer's primary, if not only, interaction with the product is through a smartphone. They never meet their customers face to face and may only rarely speak with them on the phone. A bank's face-to-face interaction with its customers is often viewed as a positive since it allows for some certainty that the person is real, but that is a false sense of confidence. The various channels a customer can use to interact with a bank mean that the bank needs to spread its risk controls more widely. By contrast, fintech companies invest more deeply in digital capabilities. That investment mainly focuses on capturing additional data signals that can paint a complete picture of customer activity to determine whether something feels off.

Three categories of data matter more than ever:

❶ **IP intelligence** — Bad actors take steps to hide their internet tracks, making it difficult to trace the activity back to them. Legitimate customers may use tools such as VPNs to protect themselves from identity theft, but more sophisticated tools such as TOR are more often than not a mark of something suspicious going on. IP intelligence monitoring can give compliance teams insight into how the customer connects to the bank's platform and prime them to ask the customer to reconnect without any masking techniques to validate who they are. Of course, this signal alone isn't enough for the most sophisticated bad actors, as they may be working with a network of compromised home computers and can route their activity through a customer's IP address without the customer knowing.

❷ **Device fingerprinting** goes a step beyond simple IP intelligence to capture additional device attributes such as

its operating system, web browser, hardware properties, languages installed, etc. Each element makes the bad actor's job more demanding since they either need to figure out how to fake everything or go out and buy a new device for each account that they open. Adding device fingerprinting capabilities can suddenly surface connections across accounts that may look wholly unrelated and otherwise completely normal, allowing you to ask some pointed questions about why they all appear to be connecting through the same device.

The prior two categories of data add technical complexity to any effort to circumvent a bank's controls. That complexity requires time and money, but it is still possible for more sophisticated bad actors to find their way through.

❸ **Behavioral signals** are the final and perhaps most potent category of data to capture. Behavioral analytics tools have become more sophisticated in recent years as tech companies understand how their customers interact with their products. Knowing where the customer was tapping the screen was incredibly valuable for designers seeking to provide the best possible experience and advertisers who wanted to know the best placement for an ad. Conveniently for bank AML teams, those same signals are clear indicators of abnormal customer behavior.

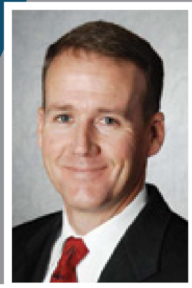
Considering bad actors' perspectives once again, it is important to remember that they also have daily lives to live. They do not want to sit at a desk and manually manage every compromised account, so they design software bots to help them. A bot interacting with its platform will look very different from a real person from a tech-savvy bank perspective. Even if there are no bots in use, there is still a good chance that the account will show signs of abnormal behavior in terms of when customers interact with the product, how long they are in the product, and what aspects of the product were used. It is also likely that they will be checking in on all of their accounts simultaneously, so the bank may see spikes in activity across many accounts that don't look to be related to one another.

Where does this leave the bad actors? When faced with a bank that has invested in augmenting its technology stack with the ability to gather all of this additional data, they are likely to take their "business" elsewhere.

Matthew Van Buskirk is co-founder and co-CEO of Hummingbird.

FirstBank Phoenix Market President Bryce Lloyd Announces Retirement After 32 Years

Humphrey Shin promoted to Phoenix Market President role



Bryce Lloyd

Humphrey Shin

FIRSTBANK, ONE OF THE NATION'S LARGEST privately held banks focusing on "banking for good," announced that Phoenix Market President Bryce Lloyd would be retiring after serving the company for more than 32 years. Humphrey Shin stepped into the role effective Monday, March 1.

Lloyd began his career with FirstBank in 1989 in their management training program. He rose up the ranks to serve in several leadership positions, including SVP and EVP, before being appointed market president in 2007, where he was charged with launching the FirstBank brand in Arizona. Under his leadership, Lloyd propelled FirstBank's Arizona presence from one location with $20 million in assets to a thriving bank with 15 branches and nearly $1 billion in assets today.

Lloyd was also integral in helping FirstBank and the Alliance of Arizona Nonprofits launch Arizona Gives Day. This 24-hour online giving movement has raised more than $23 million for Arizona nonprofits since the program's inception in 2013. Additionally, he's been involved in numerous nonprofit and business organizations throughout his career, including Coalition for the Homeless, Boys & Girls Club of Greater Scottsdale, Valley Partnership, Scottsdale Area Chamber of Commerce, and Arizona Bankers Association, among others.

"It's because of Bryce's initiative and direction that we've been able to broadly grow our mission of 'banking for good' throughout Phoenix," said Jim Reuter, CEO at FirstBank. "We salute Bryce's decades of leadership at FirstBank as he closes the book on an incredible career."

"It has been an absolute privilege to spend my career working for a company that prioritizes supporting the community," said Bryce Lloyd. "I know that Humphrey is well prepared to step into this role and will continue successfully leading our region."

Upon Lloyd's retirement, Humphrey Shin, most recently serving as executive vice president for FirstBank, ascended to the Phoenix market president's role. Shin is responsible for overseeing FirstBank's Phoenix-area branches, including its personal and business banking services.

"Having worked under Bryce and East Valley Market President Joel Johnson for many years now, I've witnessed what great leadership looks like from both a company perspective as well as from the perspective of the greater community," said Humphrey Shin. "I look forward to taking on this new role and doing all that I can for the families, businesses, and communities that we serve."

Shin has been in the banking industry for almost 17 years, joining FirstBank in 2004 as a management trainee and quickly rising through the ranks before being named an executive vice president in 2016, where he was responsible for business development, mentoring and training junior officers and managing a wide portfolio of business and commercial real estate loans. He also shares Lloyd's passion for supporting the local community, serving on the boards of numerous charitable organizations, including Valley Partnership, Goodwill of Central and Northern Arizona, and Arizona Housing Coalition.

FirstBank recently reported exceptional year-over-year growth in Arizona, with deposits growing by 34.4% from $589.7 million in 2019 to $792.6 million at the end of 2020. Loans increased 5.4% from $889.1 million to $937.3 million, and assets increased by 5.1%, from $938.9 million to $987 million. Companywide, FirstBank's total assets grew to $24.5 billion, representing a 22.5% increase, while deposits increased 22% to $21.9 billion over year-end 2019. Over that same period, FirstBank also saw net loans jump by 14.3% to $13.0 billion at the end of 2020.

About FirstBank

FirstBank began providing banking services in Colorado in 1963. Today, the bank maintains more than $23 billion in assets and operates more than 110 branch locations across Colorado, Arizona and California. FirstBank offers various checking accounts, savings accounts, home equity loans, mortgages, and a full range of commercial banking services, including financing, treasury management and deposit accounts. Since 2000, FirstBank has been recognized as a corporate philanthropy leader, contributing nearly $70 million and thousands of volunteer hours to charitable organizations. The company is also unique, as a large portion of its stock is owned by management and employees, giving employees a financial stake in the bank's success through its Employee Stock Ownership Program.

Lights, Camera, Advocacy

By Evan Sparks, Editor-in-Chief, ABA Banking Journal.
This article was originally featured in the ABA Banking Journal.

ON SATURDAY, APRIL 4, 2020, JIM RIENIETS STANDS IN A conference room at Nashville-based Insbank and looks at a video camera.

"Members of our team are working diligently to access the Small Business Administration's systems" to make Paycheck Protection Program loans, he says. "To get these funds distributed as quickly as everyone would like is akin to drinking water from the release of a hydroelectric dam."

The tone grows serious as Rieniets reminds viewers about Americans' sacrifices in previous generations during wartime and economic depression. "COVID-19 is a war. We are fighting an opponent that is threatening our lives and our way of life. In that vein, I encourage everyone to understand that we all will need to make sacrifices and do things to help one another," he says.

How does this apply to PPP? "In the first few days, demand will overwhelm the system," he warns. "I encourage businesses that have not already had to furlough employees to pause and allow those businesses that have had to close their doors to be the first recipients of these loans." Rieniets grabs a package of toilet paper and hugs it to his chest. "You don't want to be the guy or gal who's buying or hoarding toilet paper when you have plenty in your closet already!"

The blend of empathy, results-orientation and good humor on display characterize not just Rieniets' response to COVID-19 but his whole career in Tennessee banking.

"The Pandemic's Still Here."

Rieniets is spending 2020-21 as chair of ABA's Government Relations Council, working with ABA's staff and board to develop the association's advocacy priorities in a new environment with a Democratic presidency and Congress — albeit a Congress with slim partisan margins that can be expected to drive bipartisanship on major legislation.

Top on the priority list is ongoing pandemic relief, including several provisions achieved in the December COVID-19 relief package — streamlined Paycheck Protection Program forgiveness among other PPP enhancements, the extension of important

"Members of our team are working diligently to access the Small Business Administration's systems" to make Paycheck Protection Program loans, he says. "To get these funds distributed as quickly as everyone would like is akin to drinking water from the release of a hydroelectric dam."

provisions on troubled debt restructurings and other pandemic-related relief and extension of the current expected credit loss implementation date.

"We would have all hoped that would have come and gone by now," says Rieniets. "Well, the pandemic's still here, and these PPP loans are still sitting on bank balance sheets." Nine months after he cautioned clients doing OK to hold back in applying for PPP loans, he reports that some of those clients are still doing just fine, describing the results in Nashville as a "mixed bag." Insbank clients in core Nashville businesses like entertainment, tourism and hospitality are experiencing challenges, but the effect of social distancing and stay-at-home orders has fallen irregularly.

"If you're a high-end steakhouse in the downtown district, you're having a hard time of it," Rieniets says. "If you're a barbecue restaurant and your food still tastes good after it's been in a Styrofoam container for 45 minutes, you're doing pretty well."

Meanwhile, Nashville continued to see in-migration from across the country. Over the past several decades, the Music City wasn't just about music and tourism — it developed a diversified professional economy driven by health care, technology, manufacturing and publishing, attracting corporate headquarters like CVS Caremark, Bridgestone and Amazon's future third-largest U.S. corporate base. "Companies have been consistently opting to expand to Nashville. That's put a lot of fuel behind the growth here," says Rieniets.

The corporate growth has been symbiotic with population growth — the Nashville metro is home to nearly 2 million residents, up 23% in the past decade and nearly 50% since Insbank was founded in 2000. That continued in 2020 as residents left stricter coastal areas for larger homes and a more business-friendly environment in middle Tennessee, Rieniets says.

Beyond the pandemic response, Rieniets sees several other issues on the table for 2021, including cannabis banking, which is expected to be addressed by the Democratic Congress. Rieniets describes it as a public safety issue in states that have authorized various uses for marijuana. "Regardless of the way bankers may or may not think about this issue, they want to see a resolution to what we see as a real challenge," he says. "We look forward to seeing some headway."

Other focus issues will include brokered deposit reform and policies affecting environmental, socially responsible, and corporate governance, or ESG-related investments. "We're going to be working with the administration on best practices and rules of the game for how we address those issues."

Rieniets adds that bankers should not fear the political realignment in Washington. "Regardless of what you think politically, if your team is not in charge, you always think it's going to be worse than it is," he says. "That's something I'm quick to point out to bankers who've expressed concern about a change in the balance of power."

Battle-Tested

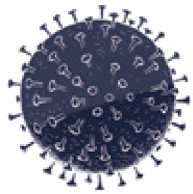
He brings firsthand experience to the bank advocacy arena, having previously chaired government relations activities for the Tennessee Bankers Association. "Seeing some of those challenges is what first spurred me to get involved at the state level," he says. There, he successfully championed elder financial abuse prevention legislation that allowed banks to delay suspicious transactions, notify close family members of any concerns and refuse to accept acknowledged powers of attorney when elder financial exploitation is suspected. The law became a model for other states.

Rieniets also played a role in stopping unfavorable legislation — an advocacy task equally important to supporting good bills. His successful efforts included blocking bills or removing provisions that would drastically increase the state's homestead exemption amount, removing banks' lien priority on commercial construction projects, says TBA President and CEO Colin Barrett.

"Jim has been an outspoken and effective advocate on behalf of the banking industry throughout his career," adds Barrett. "He's a student of the industry with knowledge of banking regulations and legislation that is second to none. Jim's leadership of the TBA government relations efforts in Tennessee moved meaningful legislation through the state's General Assembly, and I know he will have the same impact in Washington."

continued on page 26

continued from page 25



"One of the early challenges we had of having this statewide footprint and very little capital was that we weren't going to be able to build branches everywhere. We were an early adopter of technology."

For bankers looking to get involved in advocacy, Rieniets says to go for it — but for the right reasons. "Do it to the extent you have a passion for it, and you care for it," he explains. "Don't do it to try to put it on a resume. It won't do you or your industry well."

He adds that bankers should put their unique expertise within the bank to work in advocacy. "Bringing that expertise to the group is beneficial," he says. "How can you be most effective? Pick the things that you know best and lever that expertise."

Building Expertise

After graduating from Vanderbilt, Rieniets began building his expertise as a management trainee at the National Bank of Commerce in Memphis (since merged into SunTrust Banks, now Trust Financial). He became a commercial lender and then ran the small business group and correspondent lending group there.

One of his clients in correspondent banking was a board member of a joint venture working on starting up a new bank for insurers throughout Tennessee. Initially known as Insurors Bank of Tennessee — "a post-Gramm-Leach-Bliley idea that independent insurance agents would like a bank to call their own and refer clients to" — the de novo brought Rieniets on as head of credit and lending. Rieniets relocated to Nashville with his wife, Susie, and their growing family. (Jim and Susie today have three children; two college-aged and one in high school.)

With $6 million in capital, the bank's original business plan soon required a pivot as the much-vaunted integration of banking and insurance never saw the fruition envisioned by many in the late 1990s, Rieniets recalls. "If we're going to do something for our shareholders, we're going to need to shift our business model."

The bank was reborn in 2007 as Insbank, expanding its focus to businesses in the about-to-explode Nashville market. "It's really become a melting pot," says Rieniets of the growth in Nashville, which helped fuel Insbank's rise to more than $600 million in assets.

But even as Insbank capitalized on the Music City, it retained its statewide market serving insurers. "One of the early challenges we had of having this statewide footprint and very little capital was that we weren't going to be able to build branches everywhere," he says. "We were an early adopter of technology. We said, 'Let's resist the temptation to become a traditional bank.'" For example, the bank offered an ACH conversion product before remote deposits were an option to scan checks and convert them to ACH payments. It offered clients an overnight deposit service through fellow Tennessee-based FedEx.

While Insbank offers clients an up-to-date tech suite, the pandemic helped it capitalize on those investments. "The pandemic has taken that trend that was already happening and forced it on everyone," Rieniets says. Even after some semblance of normal returns, "the day-to-day banking transactions will remain in the digital space," he adds. "Our bank might be a decent example for what that looks like. Our bank doesn't handle cash or have an ATM. Our bank doesn't have a drive-thru."

Technology can be advantageous for community banks, and Rieniets is positive about the work-life balance benefits of work-from-home policies. He wants to bring Insbank's team back together eventually — "we're a firm believer in getting people together in teams to work on projects" — but Insbank employees have appreciated getting "hours back in their week to do things they want to do rather than spending time on the road" commuting.

And Rieniets has another reason to get employees and clients back together: Insbank's next film premiere. Rieniets doesn't only shoot PPP PSAs. Several years ago, he produced a 20-minute video for an Insbank event spoofing pre-crisis excesses in the financial sector. The next video, a parody of The Hangover that spoofed the financial crisis's regulatory reaction, had higher production values and was even more popular. Eventually, Insbank was renting out a local theater with multiple showings for its productions.

"It became an outlet to connect with clients," Rieniets says, adding that it tells them: "We take our work seriously — but not ourselves too seriously."

ARIZONA BANKERS ASSOCIATION
111 West Monroe, Suite 440
Phoenix, Arizona 85003

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

THIS MAGAZINE IS DESIGNED AND PUBLISHED BY THE NEWSLINK GROUP, LLC 1.855.747.4003