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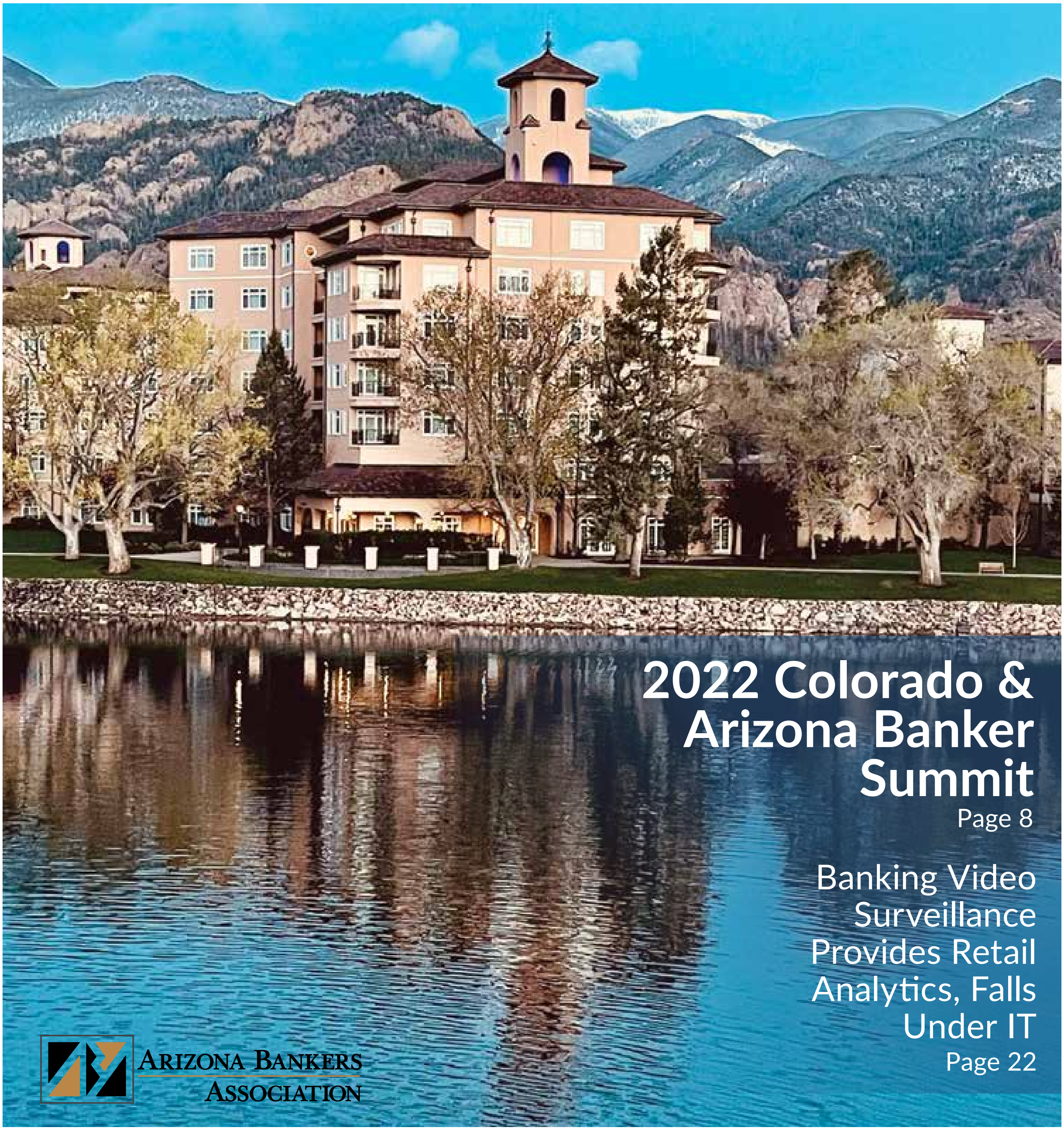

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To ensure the processes, procedures, technology, and trained staff are in place to serve this industry, bankers need to start with a plan. Having a clear understanding of what is required to serve cannabis businesses and minimize risk to the financial institution will help bankers prepare for the upfront costs associated with cannabis banking and develop the policies and procedures needed to hit the ground running. With regulations varying from state to state, it's a complex industry with high costs, requiring a considerable investment of time and energy.

Compliant banking operations require continuous enhanced due diligence to help guard against risks such as:

A Robust Illegal Market. According to New Frontier Data, the legal cannabis market in the U.S. is expected to reach $41 billion by 2025. Unfortunately, the illicit market, valued at $65 billion by some estimates, is shrinking at a slower pace. Financial institutions must ensure that funds coming through their doors are from legal channels.

Bad Actors. To ensure bad actors are not attaching themselves to good businesses, enhanced due diligence conducted around underlining beneficial owners will continue to be at a heightened level for the foreseeable future.

Legacy Cash. Because the cannabis market existed as a cash business long before legalization and because the industry continues to operate largely as a cash business, a strong BSA/AML program will help ensure that funds coming into the financial institution are from legal cannabis operations.

While the added burden and cost associated with serving this industry may limit the total number of participants in the short term, we expect competition from financial institutions to steadily increase as more states launch legal programs and we get closer to federal recognition.

Financial institutions that invest in technology to improve efficiencies and lower costs today will be able to scale as the industry grows and have a competitive advantage when the economics of the industry change over time and new banks and credit unions enter the market.

Informed by the experiences of pioneering bankers across a growing number of states with legal medical and adult-use programs, the Shield cannabis banking playbook defines a path forward for financial institutions to serve cannabis-related businesses compliantly while benefiting from the financial rewards of this market.

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Rethinking "The Great Resignation"

By Rob Nichols

American workers are quitting their jobs in record numbers — leading economists and pundits to dub the period we're currently living through "The Great Resignation."

According to the Society for Human Resource Management, employees exited their jobs in record numbers over the 10 months between March and December 2021, and the Federal Reserve continues to report ongoing labor shortages nationwide. As of February, there were 11.3 million job openings in the U.S., according to the Labor Department.

For many workers, the pandemic prompted the desire to change jobs or careers — a massive period of upheaval that led them to rethink what they wanted and needed in terms of work/life balance, job satisfaction, benefits, and more. But that's left employers scrambling to fill multiple vacancies and shone an exceptionally bright spotlight on the need to have a strategy in place for recruitment, retention and talent management. The Great Resignation is affecting businesses of all sizes across all industries — and the banking industry is certainly no exception.

While some of you may be feeling uneasy about the state of your own workforce, I submit that this is actually a time of great opportunity — because while a lot of people are leaving their jobs, it's a signal that many talented employees are also looking for jobs and are open to career changes.

That's an opportunity that our industry can't afford to miss.

To help more talented and diverse individuals find their future in banking, ABA is partnering with more than 30 state bankers' associations and pooling our resources to enhance Bank Talent HQ (www.banktalenthq.com) — the nation's single best source for banking jobs. Bankers can use **Bank Talent HQ** to post new job openings, and job seekers will use the platform to find great opportunities in banking. ABA will be busy sharing the real stories of dedicated employees in banking today.

One of the things that make our industry so attractive to prospective hires is the incredible range of opportunities that can come with a career in banking. Banks need marketers, IT experts, programmers, data wizards, cyber pros, compliance experts, and human resources gurus — not to mention all the important positions people have long associated with banking, like loan officers or tellers. Bank Talent HQ will help connect more qualified people with our industry and the exciting career path that awaits them in banking.

The Great Resignation has also prompted many banks to reconsider their benefits offerings. If you're looking for a way to bring young talent in the door to stay, one strategy I highly recommend is to offer some form of student loan repayment assistance. It's something we've tried at ABA with great success, and in my view, it's one of the ways banks can distinguish themselves as some of the best employers in the job market.

If your bank isn't offering a student loan repayment option, I encourage you to explore the possibility with your HR director. These programs can be tailored in virtually any way to support your organization's talent acquisition and retention strategy.

The reality is that many young people today are graduating college with the equivalent of a small mortgage worth of student debt. That is a tremendous burden, and stepping up to help your workers tackle this debt can set your bank apart both in recruitment and retention.

Beyond offering perks, talented professionals also need ample opportunities to advance within the organization, hone their skills or explore new areas of interest. ABA offers a wide range of online training, continuous learning and certification programs for bankers at all levels of their careers. (You can check out all of these offerings at www.aba.com/DevelopTalent.) We also support up-and-coming bank talent through our Emerging Leaders Open Committee and our new Emerging Leader Awards, which recognize the next generation of high achieving bank leaders.

> "Cultivating the next generation of bank talent is essential to ensuring the continued viability and vitality of our industry."

Cultivating the next generation of bank talent is essential to ensuring the continued viability and vitality of our industry. At ABA, we are committed to bringing you the tools and resources you need to navigate the Great Resignation — and come out on top in the search for talent. ◗

Email Rob at nichols@aba.com.

2022 Colorado & Arizona Banker Summit


EXIT

Under the Copper Dome

By John Fetherston, Director, Veridus

In a distinct echo of last year, the 2022 legislative session passed 120 days with no end in sight. While some of the session's major issues have been resolved — Prop 208 was declared unconstitutional, the Aggregate Expenditure Limit was increased, and the 2.5% flat tax was reaffirmed by the Arizona Supreme Court — the enormous budget surplus remains and so do the disagreements on how to spend it.

Since January, the state's budget surplus has only gotten more immense. What started as a projected $3.2 billion ending balance has grown to closer to $5 billion, with $1.3 billion in ongoing spending ability. While this may seem like a good problem to have, the divided nature of the majority caucuses coupled with their razor-thin margins has made budget negotiations difficult. Many Capitol observers believe that the only path to an agreement will include engaging with Democratic legislators and building a truly bipartisan budget.

So far, the 2022 legislative session has been a challenging one for the business community and particularly the financial services industry. While the Arizona Bankers Association has been able to get some important legislation passed and signed, much of this session has been dedicated to playing defense against bills attempting to regulate the activities of private businesses.

In the proactive column, the Legislature passed, and the Governor signed SB 1363, AzBA's bill to bring additional certainty to Arizona's Foreign-Country Money Judgments Recognition Act. By ensuring the Act includes a savings clause, SB 1363 maintains Arizona's position as a great place for companies from around the world to do business. AzBA also continues to advocate for action to address the state taxation of FDIC premiums that resulted from conforming to the Tax Cuts and Jobs Act. The request is for this fix to be included in the enacted fiscal year 2023 budget.

On the defensive side, the Arizona Bankers Association has been actively opposed to efforts to regulate bank activities relating to firearms and ESG policies. HB 2473 is Representative Frank Carroll's legislation that prohibits the state from doing business with any bank that "discriminates" against firearms-related business, while Representative Jake Hoffman has run HB 2637 to prohibit Arizona banks from "discriminating" based on environmental, social or similar values-based criteria. Despite violating basic small-government, free-market principles, both measures have seen significant Republican support due to concerns about cancel culture and a perceived bias from financial institutions towards conservative causes. AzBA has worked closely with pro-business legislators of both parties to keep the bills from moving forward. At the time of this writing, both measures are being held and do not have the votes to pass.

The Legislature must pass a budget by the end of the fiscal year on June 30th. Right now, it feels like this year will mirror 2021 and the session will run right up until that deadline. But this is an election year, and many legislators have primary elections to worry about; early ballots are mailed on July 6th, after all. Perhaps this pressure will be enough to keep folks at the negotiating table and adjourn sine die a little more quickly than last year.

VERIDUS

John Fetherston, Director, Veridus

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Covid-19 has accelerated the move to electronic payments. There is less need for bricks-and-mortar banking as account holders can complete just about any transaction online. To stay competitive—and retain customers—banks need to find ways to compete effectively with non-bank fintechs, large regional banks and large credit unions. The challenge in everything is to find business partners that offer leading edge technologies *and* share common goals.

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> *“UBB´s operations team manages a full gambit of payment types for its community bank customers.”*

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In the Weeds and Standing Tall

ASCPA's Cannabis Special Interest Section — The Year in Review

By Josephine Giordano, CPA, ABV, CFE, CFF, CBA, ASA, CDBV, CIRA, CICA, CTP, CCCE

The Cannabis Special Interest Section was formed to bring education and information to Arizona CPAs to better serve clients while protecting the public in this burgeoning cannabis and hemp industry.

Research shows that in 2021, Americans purchased $24.6 billion worth of cannabis products, a 34% increase over 2020.[1] This year the U.S. legal cannabis market is expected to grow by a rate of 18% to $29.2 billion. Analysts forecast that the following states will experience high growth in cannabis sales in the coming year: Arizona (20%), Florida (38%), Pennsylvania (57%), Illinois (58%), and New Jersey (74%).

For Arizona, the addition of adult-use sales gave the state's overall cannabis market a 31% boost over 2020. Arizona's licensed adult-use stores and medical dispensaries sold a total of $1.35 billion in cannabis products in 2021, $320 million more than the state's medical-only dispensaries sold in 2020.[2]

Medical Marijuana Program

According to reports filed by the Arizona Department of Health Services (ADHS), Arizona medical marijuana stores sold 147,942 pounds of product in 2021 compared to 211,557 pounds of product in 2020 and 165,722 pounds sold in 2019. According to the Arizona Department of Revenue's (ADOR) Office of Economic Research, medical marijuana retail sales for 2021 were $758.5 million with total sales tax collected of $63.5 million.

As of February 2022, there were 268,309 medical marijuana active cardholders of which 244,523 are qualifying patients. The number of qualifying patients decreased by 19% from February 2021.

Adult Use

In April 2021, the ADHS awarded 13 new adult-use cannabis retail licenses across eight rural counties. In December 2021, in a transaction facilitated by Highway 33 Capital Advisory, the license was sold, establishing a benchmark for these rural cannabis retail licenses.[3]

According to ADOR's Office of Economic Research and Analysis, total adult-use marijuana sales reported, and transaction privilege tax (TPT) and excise taxes collected in 2021 were $594,449,941, $50,069,473 and $104,137,763, respectively.

Job Growth

According to the Leafly Job Report 2022[4], the legal cannabis industry added 107,059 new jobs in the U.S. in 2021 compared to 77,300 and 32,700 jobs in 2020 and 2019, respectively. Arizona ranked eighth (23,333 jobs) out of the top ten states by cannabis-related jobs as of January 2022. Arizona added approximately 2,600 jobs in 2021.

Social Equity Program

In December 2021, regulators in Arizona began taking applications for social equity cannabis retail licenses despite ongoing lawsuits seeking to stop multistate marijuana operators from getting the permits. The deadline for would-be applicants to submit the required paperwork was December 14.[5]

Arizona marijuana regulators received more than 1,500 applications from cannabis entrepreneurs hoping to win one of the 26 highly coveted social equity permits that were up for grabs via lottery in spring 2022. The lottery took place on April 8, 2022.

280E Updates

In 2021, over 200 pages of internal documents were released by the Internal Revenue Service (IRS). According to the Marijuana Business Daily, "IRS audits of marijuana businesses have generated far more in unpaid taxes, or revenue, per hour for the agency than audits of mainstream industries." These documents, which are a must-read for all CPAs, include a participant guide, IRS reference guide, training presentations and audit project documents.

> The Secure and Fair Enforcement, or SAFE, Banking Act says federal banking regulators cannot penalize depository institutions for providing banking services to cannabis-related businesses.

Testing/Product Recalls

In June 2021, ADHS issued a voluntary cannabis product recall related to a lab's testing of possible product contamination. According to azcannabisbisnews.com, the lab indicated that the voluntary recall was not the result of any wrongdoing by the products, dispensaries, or brands, but rather an audit-based testing discrepancy between the lab and ADHS.

In December 2021, the Medical Marijuana Testing Advisory Council issued its findings and recommendations.[6]

In February 2022, Arizona regulators sent notices of intent to revoke the licenses of two marijuana testing laboratories for allegedly using procedures that could inflate product potency results. The two labs disputed the findings but have settled or plan to settle with regulators, the Arizona Republic reported.[7]

M&A Activity

Merger and acquisition activity was on the rise in 2021, with almost 3.5 times as many transactions through Dec. 17, 2021 (306 transactions), as during the same period in 2020 (86 transactions). Public companies were buyers in 86% of the deals. That included 209 in the U.S. totaling $10.1 billion in value[8] Arizona has certainly had its fair share of transaction activity in 2021.

Banking Update

According to the Whitney Economics U.S. Cannabis Business Conditions Survey, the lack of access to banking and financial services is one of the main key issues hindering the cannabis market growth.

The Secure and Fair Enforcement, or SAFE, Banking Act says federal banking regulators cannot penalize depository institutions for providing banking services to cannabis-related businesses. Championed by Rep. Ed Perlmutter, D-Colo., the House of Representatives has passed the measure six times, most recently in February 2022, before seeing it stall out in the Senate the previous five times.[9]

Hemp Update

In January 2021, the USDA published its final regulations, which became effective on March 22, 2021, for the production of industrial hemp in the U.S. In February 2022, the U.S. Department of Agriculture issued the National Hemp Report. In 2021, the U.S. planted and harvested 54,152 and 33,480 acres, respectively, of industrial hemp. Colorado planted the most outdoor hemp last year, 10,100 acres, compared to Arizona's 790 acres, but Colorado only harvested about a third of that, 3,100 acres. Montana harvested the most hemp last year, 4,500 acres.[10]

Most recently, the U.S. Department of Agriculture approved hemp production programs for Alaska, Arizona and Montana. Arizona's newly approved hemp production plan allows producers to grow and sell new products, such as hemp baby greens commercially.[11]

Looking Forward

Despite the multitude of challenges, Arizona continues to be a state to watch in 2022. As the industry matures and evolves, the economic impact is expected to materialize on both a local and national level. ◗

[1] https://www.leafly.com/news/industry/cannabis-jobs-report
[2] Ibid
[3] mjbizdaily.com 12-14-2021
[4] https://leafly-cms-production.imgix.net/wp-content/uploads/2021/02/13180206/Leafly-JobsReport-2021-v14.pdf
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[11] https://hempindustrydaily.com/usda-approves-hemp-production-plans-for-alaska-arizona-and-montana/

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2022 Financial Services Outlook: Trends, Challenges, and Opportunities

By Tullus Miller, Partner, Financial Services Practice

Activity in the financial services industry in 2021 encompassed numerous trends, challenges, and opportunities. While conversations of digital assets dominated much of the first half of the year, environmental, social, and governance (ESG) initiatives later emerged as a top concern — serving as a reminder that shareholder and stakeholder interests aren't necessarily one in the same.

The Great Resignation and the related challenges of an ever-evolving working environment, organizational fatigue, the proliferation of fintech, supply chain issues, and housing matters were also major topics.

Though the Current Expected Credit Losses (CECL) took a back seat for many in 2021, 2022 will likely see a flurry of activity no later than the second quarter in terms of accelerating readiness as organizations come to terms with adopting the standard — at least for those for which the standard will ultimately apply.

Below, we look to 2022 and beyond with potential next steps organizations can take to prepare for changes related to the following trends:

- ESG
- Fintech: Non-digital assets
- Digital assets
- Remote work environment and culture
- Mortgage banking
- Tax update
- Current Expected Credit Losses (CECL)

Environmental, Social, Governance (ESG)

Relevant Issues: ESG Best Practices

As ESG initiatives gain traction, organizations slowly move past recognizing and understanding the need for ESG strategies to implementing best practices.

Financial services companies that have yet to define their ESG goals and objectives will need to undertake readiness assessments. Human capital, social, and governance matters will likely be a top priority. Evaluating an organization's data inventory related to these areas can help serve as a cornerstone.

Climate impact remains a complex factor for many organizations. The convergence of investor and consumer demand with the overarching possibility of mandated reporting for some companies will likely propel deployment of resources to advance corporate ESG programs.

Next Steps:
Each company is unique; there isn't a one-size-fits-all solution.

Align, Plan, and Execute
No matter the size and scope of your ESG program, aligning goals and incentives, and correlating the framework to consistent ESG reporting, can help move you a step ahead. Your investors, customers, suppliers, and community all have a stake in your success. Your employees have both a stake and a responsibility to make these efforts impactful. Planning and insight, followed by execution, can help produce results for your institution.

Fintech: Non-Digital Assets

Relevant Issues: Investments and Regulations

Global venture capital investment in fintech companies exceeded $200 billion in 2021. The pace of traditional non-venture capital investment is roughly as high as well. With such large amounts of capital invested, fintech companies are succeeding in challenging the traditional business models of old-line brick and mortar financial institutions. This results in a convergence of fintechs in the market that traditional banks serve. In addition, many fintechs service markets that traditional banks have been unable to service.

Fintech companies in the Americas received roughly half of these investments, while companies in the

rest of the world received the rest. Pre-money valuations of fintech companies continue to increase substantially.

Fintech companies are subject to various levels of regulation. The regulatory environment depends upon the jurisdiction in which each company operates. However, most regulators and governments around the world have been slow to keep up with the quickening pace of these companies' activities.

Next Steps:
Prepare for Investment Growth
The pace of investment in fintech companies isn't expected to slow, at least in the short term. Consolidation and mergers and acquisitions (M&A) are expected to surge, some of which will be international.

Fintech companies that focus in the cryptocurrency area are expected to continue their explosive growth.

Digital Assets

Relevant Issues: Reporting and Tracking Requirements

The infrastructure bill attempts to redefine the definition of a broker. This could possibly push cryptocurrency exchanges like Coinbase and others to begin reporting 1099 information to the IRS on behalf of their customers, similar to requirements for traditional brokerages.

That's a starting point, but it will be difficult to assess what regulations will help track information without being overly burdensome to the cryptocurrency space and effectively slow down innovation.

1099 Tracking
Some traditional rules will be hard to follow, especially in the decentralized finance (DeFi) space where customers interact directly with a protocol rather than a human service provider. Forcing 1099 tracking or Know Your Client (KYC) rules on these types of platforms may be a near impossible ask. If 1099 tracking is possible, it could be overly burdensome to the industry.

Investors who buy and hold as a long-term investment may see similar treatment to buying and selling stock. Those who mine or stake cryptocurrency will likely end up with ordinary income treatment under Tax Notice 2014-21.

No specific guidance currently exists for the treatment of non-fungible tokens (NFTs). Digital art purchases may be deemed to fall under the IRS's definition of a collectible, which has an even higher tax rate than stock or other cryptocurrency if held long-term.

Tracking Software Applications
Those who trade cryptocurrency probably engage in numerous other activities in the DeFi space such as staking, liquidity pools, or yield farming. Many third-party cryptocurrency tracking software applications now exist to help aggregate and track various transactions, including activity on DeFi platforms and NFTs.

Transfer of Funds from Banks to Cryptocurrency Exchanges
The potential decline in customer deposits is a major issue the traditional banking sector faces. Customers are pulling out a percentage of, or in some extreme cases all, their funds from traditional banks and moving funds to centralized and decentralized cryptocurrency exchanges like Coinbase. Visa announced a new service to help banks determine how to provide services for cryptocurrency and digital asset holders. A Visa study also found that 40% of consumers who already own cryptocurrency would be

Continued on page 16

Continued from page 15

willing to switch from banks to banks that offer cryptocurrency products.

Next Steps: Watch for New Regulations

The IRS will likely need to release further guidance. The amount of IRS examinations on cryptocurrency will likely expand with the Biden administration approving an increase in funding to the IRS and the creation of a new digital assets task force.

Understand Tracking and Reporting of Digital Assets

When you have discussions with your tax preparer, they will want to fully understand your activities. It's highly recommended to have this information gathered prior to tax time, otherwise you could face a daunting task trying to track historical data and pull tax basis information. Tracking is necessary and important, as signified by the question on page one of Form 1040, requiring taxpayers to check a box if they sold or exchanged any cryptocurrency during the year.

Many centralized and possibly even decentralized platforms that act as a medium of exchanging digital assets may suddenly be required to undergo information reporting, such as issuing 1099s similar to requirements for traditional brokerages. This may help alleviate the burden of taxpayers having to find third parties to help track their crypto transactions.

The infrastructure bill also amended Internal Revenue Code (IRC) Section 6050i to also include digital assets. This means trades or businesses may now be required to include Form 8300 reporting if more than $10,000 of value in digital assets is exchanged. The prior version didn't include digital assets.

Remote Work Environment and Culture

Relevant Issues: Technology, Productivity, and Mental Health Challenges

Historically, the financial services industry has been one of the relationships built and maintained through face-to-face interaction. The impact of the COVID-19 pandemic greatly disrupted the industry and necessitated the restructuring of how professionals conduct business.

Technology, productivity, and the mental health of teams remain among the biggest challenges as organizations continue in a remote work environment.

Technology and Infrastructure

While the economy is technologically progressive, the dispersion of teams due to COVID-19 requires managing and providing infrastructure for hundreds, if not thousands, of locations and people as opposed to the limited physical locations offices were typically grouped prior. This explosion of physical locations will continue to provide technical challenges for everyone moving forward.

Productivity and Distractions

Productivity is always top of mind for managers. The deployment of teams to a virtual workforce will continue to challenge the ability to maintain productivity at an acceptable level. Distractions such as shared workspaces with a significant other, roommate, or children and miscellaneous daily tasks and nonwork-related activities can erode productivity.

Mental Health

The impact of social isolation provides a major unseen challenge to all team members. Studies show everyone needs alone or downtime, but there can be significant side effects when this time isn't wanted or is forced. These effects should be a top concern for managers as they may go unnoticed until something drastic happens.

Next Steps: Analyze, Plan, Implement, Test, and Optimize

Every process has a lifecycle. These phases include analyze, plan, implement, test, and optimize. For many years, businesses paid less attention to the test and optimize phases. Businesses that continue to deploy a remote work culture should continuously test, then strip down the process of how the business runs, to reanalyze and create a new plan and implementation of their workforce.

A successful program starts with governance at the top and includes strategies to keep your workforce engaged and productive, as well as physically and mentally healthy.

Mortgage Banking Outlook

Relevant Issues: Housing Shortages, Supply Chain, and Appreciation

The mortgage banking industry experienced another strong year in 2021. Historically low-interest rates allowed the refinance wave to continue. COVID-19-related legislative and regulatory action aimed at keeping homeowners in their homes largely succeeded. In a true testament to the industry, forbearance and delinquency rates continue to fall from 2020 peaks, highlighting the hard work of lenders to assist borrowers.

Total mortgage originations for 2021 are projected to exceed $4 trillion, the second highest year on record, according to the Mortgage Bankers Association (MBA). A forecasted rise in rates for 2022 is expected to drive a purchase origination market. However, critical housing shortages, supply chain constraints, and home price appreciations are headwinds to growth in 2022.

Mortgage Banking Industry Risks and Opportunities in 2022 and Beyond: Housing Supply and Price Appreciation

U.S. housing market inventory levels are at historical lows. The MBA origination projections hinge on the ability to construct sufficient housing to meet the growing demand. Supply chain constraints coupled with labor shortages in the construction industry pose serious risks to constructing housing. These factors contribute to the significant home price appreciation experienced in the United States. Price appreciation presents a risk to growth as many buyers are first-time home buyers.

An expected rise in rates due to Federal Reserve tapering may slow price appreciation, though additional housing is needed to calm price increases and stabilize affordability.

Demographics

Based on U.S. census data, millennials represent the largest demographic in the United States. The millennial cohort is entering their peak home-buying years and will likely fuel the purchase market moving forward.

Servicing

The Federal Reserve's taper of bond purchases is generally expected to put upward pressure on mortgage rates. Mortgage lenders, who were able to retain servicing at historically low rates, are well-positioned to benefit as valuation increases, and extended cash flow provide a natural hedge to reduced production income.

Technology

Of the nonbank mortgage companies completing initial public offerings (IPOs), many referenced their investment in technology as a core strength. Fintech companies emerged on the scene with innovative ideas aimed at improving the customer experience while driving down delivery costs.

Into 2022 and beyond, expect to see continued investment in technology that leverages data and automation to innovate and connect with consumers.

Private Label Securitization

Agency mortgage-backed securities (MBS) continue to dominate securitization volume; however, recent data from the Urban Institute indicates a rise in non-agency MBS. A jumbo mortgage exceeds the government-sponsored enterprise (GSE) conforming loan limits; a larger share of mortgages qualifies as jumbo as prices rise.

The private-label securities (PLS) market presents an opportunity for nonbank lenders as banks look to grow loan portfolios amid a rise in deposits.

Regulatory Roundup

Suspension of the Federal Housing Finance Agency's adverse market fee adjustment may prove a welcome sign of recovery. The Biden administration, however, paused talks about ending GSE conservatorship.

Under new leadership, the Consumer Financial Protection Bureau (CFPB) is prioritizing fair lending and racial equality. The CFPB's priced-based qualified mortgage (QM) loan definition became mandatory as of July 1, 2021. The impact on GSE involvement in the QM market remains unclear, though it could provide an opportunity for PLS market expansion.

Finally, the Coronavirus Aid, Relief, and Economic Security (CARES) Act and pandemic-related regulations remain in place; however, its impact wanes as mortgage-related forbearances and delinquencies decrease.

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Next Steps:
Prepare for a Purchase Mortgage Market

The forecasted increase in interest rates is likely to continue to put pressure on profit margins. Millennials entering peak homebuying years are expected to drive a purchase mortgage market in 2022 and beyond.

Invest in Technology

It's critical to invest in technology to meaningfully connect with today's consumers while maximizing profitability.

Anticipate Growing Demand

Mortgage lenders retaining servicing are well-positioned to benefit from expected increases in value. However, housing price appreciation coupled with a significant housing supply shortage are real headwinds to growth. More affordable housing is needed to meet anticipated demand.

Monitor New Legislation and Regulations

Continue to monitor developments in the legislative and regulatory landscape and the impact on mortgage lending.

Tax Update

Relevant Issues: Build Back Better Act Proposals

The U.S. House of Representatives passed The Build Back Better Act (BBBA) on Nov. 19, 2021. The bill includes numerous provisions related to health care, climate change, immigration, education, social programs, and, of course, taxes.

While the bill still faces hurdles and is subject to change should it make its way through the senate, it's important to understand the notable proposals that may impact financial services businesses and owners.

Notable highlights of the House version of BBBA include:

- Expansion of the 3.8% net investment income tax base to include active business income from pass-through entities
- Increase in the cap on state and local tax deduction from $10,000 to $80,000 through 2031
- Permanent implementation of the limitation on excess business loss deduction for noncorporate taxpayers; the limitation under the current law is set to expire after 2026
- Changes to the international tax regime, including Global Intangible Low-Taxed Income (GILTI) tax rate increase, the requirement to calculate GILTI on a country-by-country basis, and reduction in Foreign-Derived Intangible Income (FDII) deduction
- 1% excise tax on the value of stock repurchases and net of new issuance; stock contributed to retirement accounts, pensions, and Employee Stock Ownership Plans (ESOP) are excluded from being taxed
- 5% surtax on individuals with modified adjusted gross income that exceeds $10 million
- Delay in the effective date for R&D expense amortization requirement over five years — versus immediate deduction — from beginning in 2022 to 2026
- Extension and expansion of green energy-related tax credits

Next Steps:
Monitor Developments

Current proposals don't include an increase in corporate tax rate; however, the final legislation could look different as lawmakers continue to negotiate as the bill moves through the chambers. Monitor the developments in the legislation and consider tax planning strategies as the final legislation takes effect.

CECL

Relevant Issues: Adoption of CECL

Adoption of the Current Expected Credit Losses (CECL) model is imminent. Currently, only around 200 depository institutions have adopted it, notwithstanding the rekindled efforts to scope out smaller community institutions in Q1 2022, leaving over 9,000 to adopt the model on Jan. 1, 2023, along with thousands of other entities in the financial services sector.

The readiness of institutions preparing to adopt varies greatly and covers the spectrum, from ready-to-implement to those still in the preliminary planning phases.

However, it's not all additional work and increased complexity related to adopting a new model. A current Financial Accounting Standards Board (FASB) exposure draft would eliminate troubled debt restructuring (TDR) accounting under CECL.

While the proposal includes increased disclosure requirements, the simplification of the accounting and removal of TDRs may be beneficial.

Next Steps:

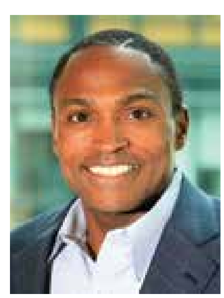
If your organization is still in the early phases, you're not alone, but it's important to know that remaining time wanes and waiting for a potential adoption exemption is a dangerous proposition. Not only is adoption an issue for internal timelines, but vendors are also reaching capacity in their ability to onboard new users.

Prepare and Adopt CECL

For institutions further along, there's still a focus on parallel runs, finalizing documentation, controls, policies, and procedures, as well as evaluating model validation requirements. As such, all institutions should start the year with a proactive stance.

We're Here to Help

For guidance in navigating challenges your organization is facing or how to implement the next steps, contact your Moss Adams professional. You can also visit our Financial Services Practice page for more articles and resources.



Tullus Miller, Partner, Financial Services Practice

How Innovative Solutions from BHG Financial Can Help Community Banks Thrive in the Digital Age

By Keith Gruebele, EVP, Institutional Relationships, BHG

Since BHG Financial's associate membership with the AzBA, they have created partnerships with 10 Banks in Arizona that have purchased $45MM in high-quality loans. They currently work with over 50 state banking associations, providing high-quality loans and services to the various association members. While BHG Financial is an industry leader in providing high-quality loans since 2001, the company has evolved to encompass a full family of brands all designed around the unique needs of community banks.

Fourteen-hundred-plus financial institutions partner with BHG Financial, a testament to their understanding of the community banking industry. It is only augmented by the fact that they are 49% owned by Pinnacle Financial Partners (a bank headquartered in Nashville, Tennessee), making them stand out among a sea of fintechs as a financial services leader with a valuable perspective.

Maybe it is their unique perspective that has allowed them to partner with so many community bankers and surround them with proven solutions for successfully navigating a constantly shifting world.

The growing importance of technology for banks and their customers

Banks are all constantly being reminded of the need to embrace technology and the digital world, while trying to also maintain security, profitability and community relationships. Rather than a one-time, one-size-fits-all service, a community bank needs a true fintech partner that grows with them, fulfilling their needs today while simultaneously predicting and developing solutions for tomorrow's roadblocks.

Right now, this comes down to technology and the modern customer's desire for a seamless online experience. According to a study by Chase, 99% of Gen Z and 98% of millennials utilize mobile banking daily for tasks that range from reviewing their account balances to checking their credit scores. A similar study by BAI shows that 58% of Gen Z prefer to open deposit accounts online rather than in person, while 75% of millennials would switch banks for a better mobile app.

When the pandemic hastened the movement towards digital, BHG Financial was prepared; having always been innovators in financial services, they were able to quickly adapt and thrive. By investing in new technology, the company created a seamless online application process, driving easy customer applications and building loyalty even with the challenges of the pandemic. Currently, 40% of borrowers return to BHG Financial for additional financing.

With the risk of identity fraud on the rise, BHG Financial invested in remote ID verification, allowing for quick and secure customer onboarding. Further, with regulation expected to increase, BHG Financial placed a high level of importance on compliance by leveraging an internal team of industry experts to ensure the company was meeting regulatory requirements.

These in-house tools helped BHG Financial nearly double in size since the start of the pandemic, and banks can take advantage of these same proven resources to grow into this new digital age – without having to invest crucial time and millions of dollars.

Lend outside your lobby with BHG Connect's digital lending platform

Consumer reports make it clear that people would prefer to manage their finances online. The good news is – with a simple integration – your bank can be a leader in digital transformation. BHG Connect, a suite of lending-as-a-service products, provides an end-to-end digital lending platform co-branded for your bank, allowing you to offer online loans to your customers.

According to a BHG Financial analysis, the average community bank has approximately $150 million in untapped consumer loan opportunities within their existing customer base. By providing your customers with the ability to apply for loans quickly and easily online, you can impact your bottom line and build loyalty with your clients.

Many customers (87% of Gen Z, according to a Marqueta report) prefer to maintain business with traditional financial institutions over fintechs. By providing a frictionless online experience, you can strengthen your relationships with these customers while still giving them the exceptional customer experience that community banks provide.

Keep your bank secure with cutting-edge AI from Vouched

Although community banks tend to know their clients well, in this age of digital fraud, it's never been more important to know your customer. Working with a proven industry partner like Vouched can enhance your fraud prevention and improve KYC/CIP (Know Your Customer/Customer Identification Procedures) requirements to keep your institution safe.

Vouched combines cutting-edge AI that visually examines a customer's identity with a multi-factor risk analysis, allowing your bank to onboard users anytime, anywhere, securely, and instantly. To date, this KYC solution has helped open over one million bank accounts and has been used to fund over $8 billion in loan transactions. Now your community bank can follow your customers across state lines, open accounts for their college-aged kids, and compliantly and safely identify them without ever needing to meet.

As a member of the BHG Bank Network, your financial institution can access this tool at a preferred pricing structure.

> "As regulations continue to evolve, banks must continue to prioritize regulatory risk management and compliance."

Stay ahead of regulatory shifts with Risk Management Solutions Group (RMSG)

As regulations continue to evolve, banks must continue to prioritize regulatory risk management and compliance. Today, these areas are top concerns for executives across the banking industry.

BHG Financial has always maintained a very stringent compliance program. They regularly undergo examinations by the FDIC and Tennessee State Banking Commission, making it a priority to ensure that all technology platforms, processes, and procedures are held to the highest standards possible.

Their top-tier regulatory team has over 500 years of combined experience, allowing them to effectively assist our banks with all federal and state regulatory agencies. Partnering with BHG Financial allows your bank to access their expertise with zero obligation to execute a work order. Banks can complete a client agreement and have RMSG on deck when situations and questions arise. Further, in the event that work is needed, RMSG can provide you with a quick and free estimate.

It's your turn to experience the BHG Financial advantage

The AzBA couldn't be more appreciative of the partnership BHG Financial has developed with us and our banks across the state. Their technology solutions are tailored to the challenges of the community banks.

As our industry continues to evolve, finding a partner like BHG Financial that can provide cost-effective and efficient products and services that support banks' needs is more important than ever.

To learn more about BHG contact Keith Gruebele, EVP, Institutional Relationships, at 954.737.5318 or kgruebele@bhgbanks.com. Or visit our website at bhgloanhub.com/keith.

Banking Video Surveillance Provides Retail Analytics, Falls Under IT

Most IT departments are now heavily involved with vendor evaluations and lifecycle management of security equipment. Join us to learn more about how this mindset is changing and vendor due diligence is more important than ever.

By: Steve Ryker, CPP, VP of Risk & Compliance, Cook Solutions Group

What is the Lifecycle Of Electronic Security Equipment?

Financial institutions have a history of installing the latest security equipment for new construction or remodeled administrative facilities or branches. Many lack a strategy for maintaining the equipment or an end-of-life replacement strategy. This approach is not ideal for maintaining consistent quality or performance over time. The lifecycle of electronic security equipment is typically five years. The need for maintenance increases throughout the life of the equipment and quality decreases over time. Keeping equipment active beyond the end-of-life timeframe significantly decreases the quality of protection afforded by the equipment. A common symptom of equipment beyond end-of-life includes video images not effective at identifying suspects due to decreased image quality. Another common symptom is failure of the equipment at a time of critical need, such as during a bank robbery, or fraudulent transaction.

Electronic Security Equipment as Technology Assets

Financial institutions have transitioned or are in the process of transitioning from analog to IP-based electronic security equipment. IP-based security equipment is an immense step forward in functionality, integration capability, and quality. IP-based equipment connected to the financial institution's network must be managed much differently than outdated analog equipment. IP-based security equipment must be patched, firmware updated, and penetration tested to verify cyber hardening is effective to prevent malware or hacking. A major trend is to treat IP-based security equipment as information technology assets and manage them just like servers, desktops, and laptop personal computers. Lifecycle replacement of security equipment is needed for the same reason lifecycle replacement occurs with laptops and smartphones. Technology assets at some point are no longer functional. Can you imagine trying to complete daily work on a ten-year-old smartphone or laptop? Equipment beyond end-of-life presents the following challenges:

- Are the devices capable of encryption?
- Can you patch the operating systems and is the firmware still supported by the manufacturer?
- Does the storage capability of video system allow for 90 days of stored images?
- Can the video, access control, and alarm systems be integrated versus just operating independently?
- Are the systems capable of incorporating artificial intelligence and camera analytics?

Developing an Electronic Security Equipment Lifecycle Roadmap and Program

Another trend is the partnership between facilities, security, and information technology to collaborate on the development of electronic security equipment business requirements. The business requirements drive the selection of equipment for acquisition by the financial institution. Including lifecycle replacement program planning into the process adds tremendous value and efficiency. Begin by developing an equipment database by location. The equipment database will help to determine where existing equipment, based on the age of the equipment, fits into the equipment lifecycle. The database should include the equipment manufacturer, the number of security equipment components, location inside or outside the facility, install date of the equipment, and the vendor that completed the installation. The database also allows you to perform annual analysis ahead of the budget cycle to plan for the consistent replacement of equipment that has reached the end of life. If your financial institution plans multiple years ahead, the database provides the information necessary to project annual budgets years in advance. One of the best ways to gather information for populating the database is to have your contracted service vendors complete an equipment questionnaire when they perform annual preventative maintenance. This approach reduces the costs of time and travel.

The next step is to determine the lifecycle of each component. A common target is five years for electronic security equipment. Some financial institutions may choose to integrate branch or administrative facility risk into the end-of-life decision criteria. An example would be higher-risk facilities — data centers, cash vaults, and branches with higher crime history — that are first in line to receive end-of-life replacements at five years.

Another component of the lifecycle program is a list of approved electronic security products that meet or exceed the financial institution's cyber standards in addition to the business requirements. A semi-annual or at least annual review of your approved products is recommended to make sure you are spending available electronic security equipment budget dollars on equipment that performs to your standards for the present and future. If a component or components no longer perform to standards and updates are not readily available, it is time to find a different product that does meet or exceed your standards, rather than adopt a constant "like-for-like" or a complete system "rip and replace" all equipment strategy. The lifecycle replacement process enables financial institutions to infuse their security systems annually with current components as older equipment reaches end-of-life.

One emerging method of managing your electronic security equipment lifecycle program is an alternative to the typical purchase and five-year depreciation ownership model. For a smaller up-front cost and fixed monthly fee, there are trusted vendors that supply electronic security equipment that meets or exceeds your business and cyber standards for as long as you keep the agreement in place. Increasingly, organizations have found that equipment ownership is no longer an effective strategy for them, based on the value of the equipment at end-of-life and ever-advancing technology offering new features faster than ever before.

Electronic Security Equipment Can Do More

Keeping electronic security equipment refreshed at end-of-life, cyber protected, and high performing is not easy. Funding for electronic security equipment competes with all other financial institution expenditures. Traditional customer-facing systems are often prioritized over electronic security equipment in the competition for limited funds. Others may view electronic security equipment as customer-facing based on the protection these systems provide members and employees. Modern electronic security equipment can do much more than in the past. Camera analytics such as heat mapping can monitor member activity within public areas of the branch for marketing and customer experience analysis. A robust lifecycle replacement program can benefit your financial institution by maintaining equipment that protects the traditional methods and adds additional value in non-traditional ways as technology continues to rapidly evolve.

Lending at the Intersection of Mission, Technology, and Heart:

DreamSpring Earns Innovation Award for Advancing Equity Through Entrepreneurship

DreamSpring

Funding business dreams, vitalizing communities.

Sharquita Pearson has always been passionate about working with children. She relocated to Arizona from Illinois as a teenager to help raise her younger brothers and sisters. Today, as the owner and operator of Little Giants Daycare and Learning Center in Phoenix, Sharquita has harnessed her love of children and learning into a livelihood that serves her community.

"It amazes me what kids are capable of at such a young age," Sharquita says. "Watching them learn to crawl, walk, and say simple words makes my heart melt. I'm so excited to give Little Giants a fun and exciting place to play and learn."

When she needed funding to support her growing business, Sharquita applied for a small business loan with DreamSpring, a nonprofit community development financial institution serving Arizona and 18 additional states. With funds to expand, Sharquita has sustained jobs, increased enrollment of infants and young children, and enhanced her curriculum to emphasize music, movement, mathematics, play, art, and language.

Every day, entrepreneurs like Sharquita quickly access affordable small business capital through DreamSpring's innovative hybrid lending model, which combines a streamlined online application process with tailored

support from a community-minded staff. With options for self-directed or guided workflows, small business owners can access funds in the format that best meets their needs. DreamSpring has a deep commitment to economic opportunity as well as a network of resource providers, providing ongoing encouragement and support to small business owners — empowering entrepreneurs, creating pathways to prosperity, and vitalizing communities.

In March, DreamSpring was selected as one of the World's Most Innovative Companies for 2022, Fast Company magazine's prestigious annual shortlist of global changemakers. The award recognizes DreamSpring's unique combination of mission-driven lending and technological enablement, which gets money into the hands of small business owners not only quickly, but equitably.

"We believe that human potential is unleashed when all people have the opportunity to shape their own future," says DreamSpring Founder and President/CEO Anne Haines. "We exist to break down systemic barriers that inhibit that reality for people, and we do it through entrepreneurship. As the needs of small business owners evolve, our team will continue to create innovative solutions that carry a transformational impact."

The COVID crisis spurred DreamSpring, a 30-year-old institution, to break new ground in its overall strategy and breadth of service coverage. On the heels of the pandemic, Haines launched a bold growth plan to scale the organization's impact tenfold by leveraging technology and digging into placemaking work.

With a combination of leading-edge partnerships, philanthropic support, and a savvy approach to technology, DreamSpring was able to surpass its ambitious goal last year. DreamSpring provided $225 million in capital through 26,000 small business loans in 2021 — a dramatic increase in volume over prior years. To respond to the unprecedented demand from small business owners, DreamSpring invested in technological enhancements that expedited loan decisions and streamlined the client experience. DreamSpring clients created or retained over 44,000 jobs despite economic uncertainty, thanks to funding and ongoing resources provided by the organization.

"We are powered by technology and a commitment to economic justice," says Francisco Lopez, DreamSpring's Chief Operations and Innovation Officer. "The combination of a tech-enabled approach and a deep mission focus continues to drive us forward."

Because of DreamSpring and its innovative, award-winning lending model, Arizona entrepreneurs like Sharquita can thrive. Learn more about DreamSpring and community development financial institutions at www.DreamSpring.org.

Leadership Tips:
Choosing the Right Products & Services

By Rob Schwister, EVP and Director of Banking Programs, Equipment Leasing Services

> As a leader, you need to choose your partners carefully. Your reputation, the reputation of your bankers, and the reputation of your bank often depend on the independent abilities of your partners.

If you are in a leadership position at a financial institution, I'm sure you are bombarded with opportunities to learn more about all sorts of new products and services from an endless line of providers. Having served in several leadership roles, most recently as Market President for a community bank for the past 12 years, I can certainly understand why you budget your time wisely and choose to focus on things that will help your business the most. In my experience, I was always most interested in partnering with companies that offer products and services that have a direct impact on my ability to provide a better experience for my clients.

Several years ago, I established a relationship with the team at Equipment Leasing Services (ELS), a leasing company based in Scottsdale that has been in business since 2000. There are a number of reasons why I felt it important to partner with them. I'll share those reasons with some specific examples:

- As a small community bank, not only did we have challenges regarding legal lending limits, but we also had internal hold limits that restricted our ability to meet the needs of some of our borrowers. In one example, we had a client who had received financing for multiple owner-occupied commercial real estate properties, as well as an operating line of credit. The client was growing, and we anticipated some future needs for an expanded line of credit. So, when they came to us with a request to finance some equipment, we brought in ELS to structure leases to meet their needs. This allowed us to meet the client's needs, maintain the relationship, and leave lending capacity for the increase in the line of credit.

- In another circumstance, we had a client growing rapidly and bumping up against covenants established for their line of credit. In this case, an operating lease structure was appropriate as the assets were owned by ELS and leased to the client, so it did not impact their balance sheet. In addition, the timing of the request was about six months prior to the line of credit maturity, and since our underwriting team was extraordinarily busy with other requests, it made sense to partner with ELS for the interim request so as not to overwhelm the underwriting workflow.

- Finally, we had a client with multiple brick-and-mortar locations who decided to venture into a mobile delivery format. While the relationship was very strong and cash flow positive, we determined that given the collateral (vehicles) and the need to maximize the advance rates, a lease structure was best. So, ELS stepped in, helped structure the leases and acquire the vehicles, and the customer continued to grow their business.

In all of these examples, several things were consistent. First of all, ELS always worked as a partner with the Bank, meeting with clients, serving their needs, and helping the bank expand the relationship. They always conducted themselves in a professional manner, as you would expect with a strategic partner. Secondly, ELS always provided its products and services in a timely manner, meeting the expectations of the bank and the client. Finally, they communicated well. They never left a banker or client hanging, waiting to hear the status of a request.

As a leader, you need to choose your partners carefully. Your reputation, the reputation of your bankers, and the reputation of your bank often depend on the independent abilities of your partners. I learned to trust the team at Equipment Leasing Services so much that when I had the opportunity to join their organization, I jumped at the chance. As the Executive Vice President and Director of Banking Programs at ELS, I look forward to helping you meet the needs of your clients in the same way they helped me with my clients for over a decade.

Arizona Bankers Association

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