News, Analysis and Perspective for Community Banks by the Nation's **First** Bankers' Bank

UBB First for Your Success™

Independent

Winter 2022

A Quarterly Publication of United Bankers' Bank

Member FDIC

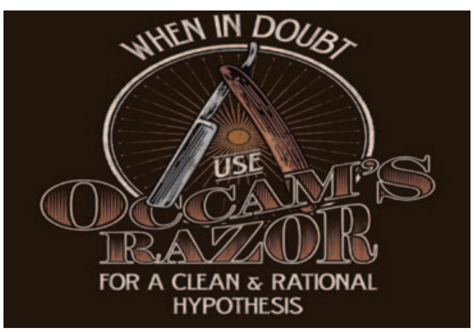
This Issue:

Using Occam's Razor to help us invest in a rising rate scenario.

By Ben Eskierka, UBB Investments

The phrase was recorded in 1852 by Scottish metaphysician, Sir William Hamilton. Hamilton credited William of Ockham, a 14th-century English monk and philosopher, with formulating his namesake, Occam's razor - "More things should not be used than are necessary." In other words, when trying to make sense of something (especially between two competing alternatives), it is best to avoid the more elaborate explanation – shave it off, like a razor. We can use Occam's razor as a handy rule of thumb when making investment decisions as well.

Occam's razor: The simplest explanation is most likely the correct one.



When it comes right down to it, no one really knows what the future holds, so the best we can do is the best we can today. A truism of fixed income investing is that it all comes down to Volume, Spread, and Time. These three components make it all go. If we do not have any Volume (Par Value), we are not going to make any money. If we do

Occam's Razor continued pg 2

Dwight Larsen A note from the President

As we usher in a new year, I hope this edition of the Independent finds you and yours healthy and optimistic for what 2022 has in store. While still navigating the uncertainties and disruptions caused by the ongoing pandemic, we at UBB are excited to be hitting the New Year in stride. 2021 represented a record year for performance at UBB, and that momentum has spring boarded us into the development of several new initiatives aimed at helping community banks tap into the developing FedNow instant payment market. UBB has taken a leadership role with the FedNow instant payments platform to ensure the voices and needs of community banks are fully represented. We'll be announcing more details about our instant payment solutions in the future as they become available.

In this issue's cover story, we feature our Chief Investment Officer, Ben Eskierka, who proposes the problem-solving principle known as Occam's Razor to strategize current and future investment decisions.

The Bank Secrecy Act (BSA) assists U.S. government agencies in detecting and preventing money laundering, and requires every bank to establish a BSA/AML program. When a bank's BSA program is deemed unsatisfactory, the punishment, whether it be monetary or reputational, can be crippling. UBB's Senior Compliance Specialist, Suzanne Rosenthall, digs into a recent case involving a community bank who was slapped with an $8 million civil money penalty for BSA violations. Suzanne explores what went wrong and how to keep it from happening at your bank.

As bankers we have a pretty good grasp of Return on Investment (ROI) and how it can be used to determine your next strategic move. RiskScout, UBB's emerging market compliance partner, dives deeper into ROI and its integral part in growing your bank through the entrance into higher-risk markets.

Financial Literacy month is just around the corner. UBB's financial literacy partner, Banzai provides a school sponsorship program that can help banks connect with their next generation of customers and even earn CRA credits. Check out this issue's Q&A on page 5 to learn how implementing the Banzai platform can earn CRA credits for your bank. In this issue's Employee Spotlight we feature our Bank Cards & Payments Manager, Brian Thraen. Learn more about Brian on page 4. Then flip over to page 6 to find out how Hardin County Savings Bank is *Keeping the Community in Community Banking*.

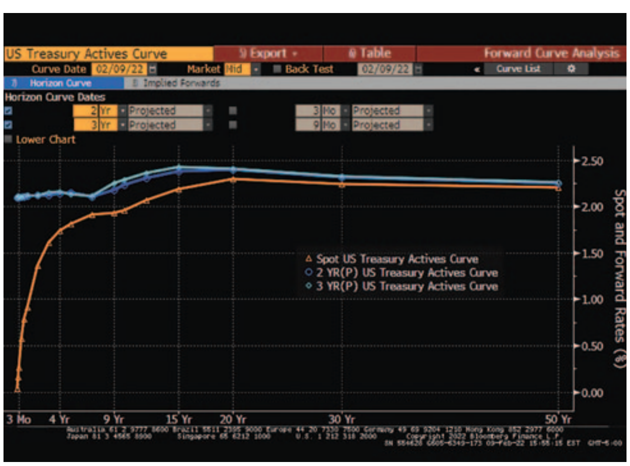
As the banking industry continues to change and evolve, UBB will be actively monitoring these advancements to ensure we are providing the products and services our community bank customers need to remain viable and competitive in the markets they serve. UBB will be *First For Your Success* today and into the future.

not have any Spread (Additional Yield above our Cost of Funds), we are not going to make any money. If we do not give it any Time (Money never sleeps), we are not going to make any money. When you put these things together, it is very powerful.

The Fed is currently in the process of slowing its purchases of Treasuries and Mortgage-Backed Securities (QE) with a plan to halt purchases altogether by March. This will be followed by the first in a series of increases in overnight rates (FF & IOER). The next step will be to stop reinvesting the cash from existing holdings as they mature, thereby shrinking the balance sheet that had been expanded to help the market function and support the economy. The runoff will continue until the balance sheet reaches the point where the supply of bank reserves is slightly above demand. I hope the Fed will favor balance sheet runoff to faster rate hikes to help limit the flattening of the curve, thus supporting banks.

The runoff should push up yields on longer-dated bonds and widen MBS spreads. History suggests that 10-year yields will not peak before the first rate hike and should move even higher as they progress. Over the last 40 years, the peak of a Fed rate tightening cycle has only been higher than the previous peak on one occasion (1991), but the Fed has always tightened to a level above the existing inflation rate.

The big theme in rates markets over the next couple of years is likely to be higher yields and a flatter curve with the potential for inversion in 2024 or 2025 at the end of the tightening cycle (see table). That is when we will want to have money available to reinvest and perhaps extend maturities ahead of an economic slowdown.



Bloomberg LP. Orange is current, Dark Blue is 2 years forward and Light Blue is 3 years forward

So how can Occam's razor help us invest in a rising rate environment?

We need to understand everything through the lens of our balance sheet and our ALCO. We must also know how the Investment Portfolio fits into our overall strategy, but we should not overthink. Margin compression is real and likely to get worse unless we do something about it. Sitting on cash is not a strategy; it is speculation. We can use Occam's razor by keeping things simple and remain fully invested or nearly fully invested because we need the earnings. Mark to market is a consideration, but it should not get in the way of doing the right thing to improve profitability and increase earnings.

The bond market has executed a reversal of pandemic price action and yields are the highest since early 2020. I particularly like the 2 to 4 year part of the curve. It is the steepest part of the curve and gets out far enough to pick up meaningful incremental income but not too far to encounter potentially significant pain. It also allows us to match up our maturities with the end of the hiking cycle.

With the 3-year Treasury yield currently at 1.25%, which has doubled in the last three months, you earn 70% of the yield of the 10-year note yield with only 30% of the duration. Be mindful that yields are likely to continue to move higher, particularly on the short end, but that is exactly what we want to happen. Our biggest risk as bankers is that rates stay low or move lower over time, and the longer we wait the higher rates will have to be to make up for the lost time.

You will get protection over the next year when overnight rates are likely to be .75-1.00% and up to 2.50% over the next three years, which is the high end of the Fed's projections and well above current market expectations. The market usually underprices the full magnitude of monetary tightening initially. The steepness on this part of the curve also allows us to roll down quickly, which helps offset some potential market value depreciation.

Balance sheet runoff will not lead to quantitative tightening before the excess liquidity is drained by the summer of 2023. Until the excess liquidity is removed, we should not expect our liquidity situation to change significantly.

Please contact your UBB Securities representative or me if you have any questions or would like assistance.

Ben Eskeirka, Chief Investments Officer, 800-558-6875 ben.eskierka@ubb.com

CommunityBank of Texas: A Case Study of What Caused an $8 Million BSA Fine

By Suzanne Rosenthall, CAMS

In December 2021 FinCEN announced that it had assessed an $8 million civil money penalty to CommunityBank of Texas, N.A. (CBOT) for willful violations of the Bank Secrecy Act (BSA) and its implementing regulations. This penalty was in addition to a $1 million civil money penalty assessed by the OCC for related violations. FinCEN agreed to credit the $1 million OCC penalty resulting in a penalty of $8 million to be paid to the U.S. Treasury in total. Banks of all sizes can learn from the mistakes made by CBOT.

With an asset size of just under $4 billion, CBOT operates 35 branches in and around Dallas, Houston and Beaumont, TX. The bank admitted to willfully disregarding lawful obligations to develop, implement, and maintain an effective AML program and to identify and report suspicious transactions to FinCEN. These violations, occuring between June 2016 and June 2021, were identified in a few different areas.

The bank was found to have an understaffed BSA/AML compliance function consisting of one BSA Officer and 6 – 8 analysts. Each analyst reviewed an average of 100 alerts per day that were generated by the bank's automated transaction monitoring system. However, the supporting documents, which were readily available, were often not reviewed or analyzed, and CBOT did not support the decision to close the alert. In addition, to reduce the number of alerts, the BSA Officer applied exemptions for customers whose activity was thought to be well known with no documentation in place to support these adjustments. This eliminated approximately 1,000 alerts in 2019 alone. The customers who were exempted included those later arrested for, or convicted of, financial crimes. As a result of these failures, it was determined that the bank willfully failed to file at least 17 Suspicious Activity Reports (SARs), equaling $100 million in suspicious activity, in a timely and accurate manner.

Banks must ensure their BSA/AML compliance function is adequately staffed so all alerts are reviewed and the analysis supporting the conclusion (that the activity is not unusual or suspicious) is thoroughly documented. Some automated transaction monitoring systems may have a function that enables a bank to suppress alerts for a defined period of time, such as one month. If the bank wants to utilize that function, the reasons for this decision must be well documented. In addition, once the suppression period has ended, the bank should ensure that activity for that time period is reviewed and any decision to continue suppressing alerts is documented again.

The bank also had systemic issues with their customer due diligence (CDD) process concerning a process to review customers at account opening and obtain information about expected activity. If CDD forms were incomplete, staff obtained additional information from account officers rather than from the customer, and critical information was not obtained. In addition, the bank did not update this information when warranted. Customers were reviewed 90 days after account opening and subsequently monitored through the transaction monitoring system. This system triggered alerts if the customer's activity was inconsistent with their prior activity or inconsistent with activity in their peer groups. This process failed to allow the bank to fully understand the true nature of the customer's activity and the legitimacy of those transactions. For example, the customer's activity may have been consistent with prior activity, however, it did not allow the bank to detect if the initial activity was legitimate.

BSA Fine continued pg 5

United Bankers' Bank
Call Report (unaudited)
12/31/2021

Balance Sheet (000's)

Assets:	
Cash and Due from Banks	$ 279,069
Investments	$ 261,369
Fed Funds Sold & Securities Purchased Under Agreement to Resell	$ 31,733
Loans	
Outstanding	$ 676,609
Loss Reserve	$ (12,257)
Other Assets	$ 36,371
TOTAL ASSETS	$1,272,894
Liabilities and Capital:	
Deposits	$ 980,817
Fed Funds Purchased	$ 161,354
Other Liabilities	$ 7,175
Equity Capital	$ 123,548
TOTAL LIABILITIES & CAPITAL	$1,272,894

INCOME STATEMENT (YTD)

Interest Income	$ 27,384
Interest Expense	$ 1,478
Net Interest Income	$ 25,906
Loss Provision	$ –
Net Interest Income (After Provision)	$ 25,906
Other Income	$ 24,183
Total Income	$ 50,089
Operating Expenses	$ 32,622
Securities Gains (Losses)	$ –
Net Income Before Taxes	$ 17,467
Tax	$ 4,580
NET INCOME	$ 12,877

Employee Spotlight

Brian Thraen

Bank Cards & Payments Manager
952-885-9458 • brian.thraen@ubb.com

Family Members: I have one brother and 3 nieces and nephews. I look forward to taking my oldest nephew to Vegas for his 21st birthday this year.

Pets: None

What do you listen to on your drive to work: Top 40 from the 90s.

Interests: Watching Netflix, relaxing at my parents' cabin near Alexandria, MN and spending time with friends.

If I could live anywhere in the world, I would live in: London. Good food, great shopping, and endless pubs with cask beer.

If I could have one super power (besides flying), it would be: Regeneration so that mistakes and rogue ideas won't be detrimental to my health.

Many people don't know that: I am much older than my appearance portrays.

If I was not working in banking, I would: Be a travel advisor or blogger about all the fabulous places one should visit.

I started working at UBB in: November of 2020

My favorite part of working for UBB: Getting national holidays off, okay everyone loves that part. I really enjoy my fellow employees all of whom are cordial and respectful to each other.

The best advice I ever got was: Don't eat the yellow snow. Got that tip as a child, and it has been holding strong as solid advice throughout my time so far.

First For Your Success means: Knowing that UBB employees' are there to help you succeed in business regardless of your knowledge and background.

Brian with friend at Mondona release party

Brian trying out a pottery spin class

BSA Fine from pg 3

The Final Rule on Customer Due Diligence and Beneficial Ownership requires that banks understand the nature and purpose of customer relationships to develop customer risk profiles. This often involves questions at account opening about the expected activity (transaction types, the frequency of various transaction types, and the anticipated dollar amount of transaction types). For commercial customers, banks must be able to develop an understanding of the nature of the business and how the anticipated activity supports legitimate business activity. Banks must also conduct ongoing monitoring of customer activity to see if it is consistent with expectations for that particular customer given the nature, the size, and the location of the business.

In summary, CBOT was found to have violated the Bank Secrecy Act by willfully failing to implement and maintain an effective BSA/AML program; failing to report hundreds of suspicious transactions to FinCEN which involved illegal activity by the bank's customers even after the bank had reason to believe that certain customers were subjects of criminal investigations; causing millions of dollars in suspicious transactions involving tax evasion, illegal gambling, money laundering, and other financial crimes to go unreported; and enabling criminal activity by depriving law enforcement of critical financial intelligence.

An effective BSA/AML compliance program is built on the effective implementation of five pillars: (1) a set of internal controls, policies, and procedures; (2) designation of a qualified BSA Officer to oversee and manage the program; (3) independent audit; (4) ongoing training; and (5) a risk-based customer due diligence program that includes beneficial ownership certification for legal entity customers. If any of these pillars are weak or ineffective, the entire program may be compromised.

In the case of CommunityBank of Texas, the bank did not have an effective BSA/AML compliance program as it failed to implement sufficient internal controls, policies, and procedures. In addition, CBOT did not have a thorough, risk-based customer due diligence program in place. The bank's system of internal controls was not sound due to the absence of adequate staff to review alerts triggered by the transactions monitoring system. The processes in place to manage the alerts were not risk-based, and the bank failed to document or otherwise support decisions they made in an effort to manage the volume of alerts. The bank's due-diligence program did not allow it to develop a true understanding of the nature and purpose of customer relationships which would allow for effective ongoing monitoring of their activity or the detection of suspicious activity.

Banks must ensure each pillar of their program is robust in order to ensure an effective BSA/AML Program. The price a bank may pay for failure to do so is high and may involve financial risk in terms of fines, operational risk evidenced by the need to replace the entire BSA/AML team, and reputational risk.

How does Banzai's school sponsorship program qualify for CRA Credits?

A: Banzai's school sponsorship program provides banks with an opportunity to earn CRA credits for both service hours and donation dollars. Service hours can be earned by doing in class presentations for sponsored classrooms, and donation credits can be earned by sponsoring the Banzai program for local schools.

In addition, banks can utilize all Banzai content on their websites to create unlimited sponsor pages for any of their own non-profit, community partners. Doing so shows examiners a clear picture of community engagement and investment.

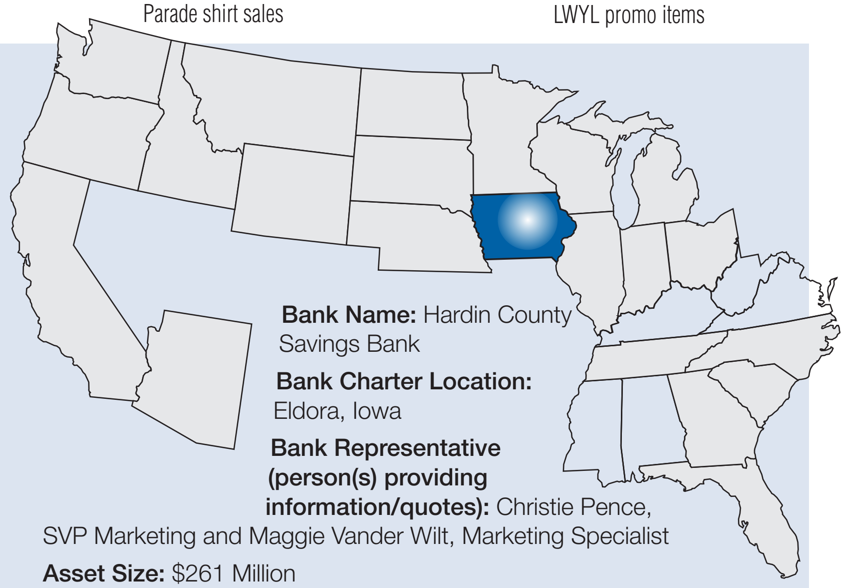
Keeping the *Community* in Community Banking

Hardin County Savings Bank • Eldora, Iowa

Situated in the middle of farm country in north-central Iowa, Hardin County is a hidden gem for outdoor enthusiasts, offering a wide range of activities from camping and canoeing to hiking and hunting. Located in the county seat of Eldora, you'll find Hardin County Savings Bank (HCSB). For the past 150 plus years, HCSB has been serving the banking needs of the Eldora and Union communities. We sat down with Christie Pence, SVP of Marketing, and Maggie Vander Wilt, Marketing Specialist, to find out more about how Hardin County Savings Bank is *Keeping the Community in Community Banking*.

Parade shirt sales

LWYL promo items



Bank Name: Hardin County Savings Bank

Bank Charter Location: Eldora, Iowa

Bank Representative (person(s) providing information/quotes): Christie Pence, SVP Marketing and Maggie Vander Wilt, Marketing Specialist

Asset Size: $261 Million

Number of Locations: 2

Number of Employees: 37

Year Bank was Incorporated: 1868

City Population: 2,700

LWYL Logo

What is your community most known for?
Eldora is the home of Pine Lake State Park and is nestled along the Iowa River. We are known for year-round recreation. As the county seat, we are proud to have our historic Hardin County Courthouse, built in 1892, in the center of the town square.

How is your bank involved in the community and what programs does your bank have to encourage community involvement?
We provide and sponsor numerous programs for our schools and community. These include a Cash for Schools program tied to debit card usage, shop local campaigns, and annually gifting employees with community dollars to spend at local retailers. We also participate in parades and benefits, bingo events, surrey rides at the Christmas festival, and sponsor teacher meals and events. In 2021, we promoted a special campaign to support and encourage locally owned small retail businesses in and around Eldora. Last January, we launched our *Love Where You Live* program where we highlight a local business. We even create t-shirts for sale through a local retailer. We also highlight a locally owned business in our customer newsletter every month and follow-up with a newspaper article, e-newsletter and social media posts.

What makes community involvement important to you and your bank?
When we speak with community and school groups, we often use words like partnership, commitment and loyalty which all embody our tagline "Together With You for Life." In order for smaller rural communities to survive and thrive, we must support and encourage each other to shop local, play local, give local and serve local. We know that the success of HCSB depends on our ability to serve and provide our customers with great banking products and financial support. But, we also want our communities to know that we are here for them throughout the good and the bad times of life. We deeply desire for our customers and community to have great success, and when this happens, HCSB also succeeds.

What do you like best about your community?
Our communities are full of great people who work hard and serve with passion. Our local schools are a source of pride and the hub of community activities. Even with the setbacks, as the result of losing a couple of larger employers in the past 20 years, we have a community filled with "yes" people. Yes, how can we help? Yes, we can fill that need. Yes, I will serve in that role.

What do you like best about being a community banker?
Hardin County Savings Bank is of course, first and foremost a bank, but it plays many other roles within our communities. As community bankers, our staff participates in leadership roles that plan for the future of our rural Iowa communities.

Significant Return on Investment with Emerging Markets

By Justin Fischer, Co-founder and CEO - RiskScout

The Return on Investment (ROI): your CFO's dream, the Board's best friend, and usually the deciding factor on whether your idea becomes reality. ROI is not just how you determine if a venture is financially viable, it's how to determine what ideas are the highest and best use of limited resources available at your institution. It shows the per dollar return you achieve on cost and is a powerful tool to convince stakeholders that your idea is a well-analyzed and tangible solution.

At RiskScout, we often meet with bankers who are considering the ROI of a new market such as cannabis, hemp, private ATMs, Money Services Business (MSBs), crypto, etc. Bankers come to us looking for ways to grow their non-interest income and customer portfolio, and see higher-risk business lines as a means of doing that. The bankers view the compliance and risk as an obstacle to venturing into those non-traditional spaces and want to explore our commercial BSA platform as a means of eliminating that blocker towards growth. Once they envision the growth potential with the risk mitigation of thorough underwriting and due diligence of the higher-risk business, they can see the path towards impactful growth without increasing overhead via automation.

Determining Revenue

Evaluating a program starts with market research. You need to understand the total addressable market, how much of that market the institution can feasibly support, and how long it will take to build market share.Typically you can expect the beginning phase of your new venture to operate at a low level of profit, or even in the negative while you scale up.

Once you've determined the addressable market, determine the type and amount of revenue that can be earned. Sources may include fee income, lending income, interchange fees, and other opportunities specific to the offering provided by your financial institution. Revenue may differ by different types of customers within the same industry, so make sure your revenue estimates accurately reflect the types of customers you will be engaging.

Breaking Down Cost

Cost is determined based on a variety of factors, typically software or other solutions in combination with the hourly wage of dedicated staff. In the below example the number of Full Time Employees (FTEs) increases as the program scales, as opposed to leveraging software that may reduce the time dedicated to certain processes. While we only look at the hourly wage of these employees there may be costs associated with hiring, training, facilities, or other operational processes that detract from profitability.

When discussing the scale of your program, look for ways to reduce cost with your increased size. Many times this is achieved through outsourcing to a third party or software solution. But it can also mean delegating lower skill portions of your program to lower wage workers, thus increasing your staff's skillset while minimizing FTE driven expenses.

Scaling ROI with RiskScout

Using a third party to improve employee efficiency is one way to better your return on investment. In the example above we saw where an institution only scaled through employee growth to be able to support increasing workload. The below example shows revenue and expenses based on real times an institution would face if scaling solely with personnel. The example institution has not realized any efficiencies, and the cost of skilled employees as well as difficulty in finding them presents challenges in scaling effectively and significantly limits profitability.

	State Today	Manual At Scale	RiskScout At Scale
	10 Customers	**120 Customers**	**120 Customers**
Revenue	$101,563	$1,218,750	$1,218,750
Salary Expense	$59,497	$713,966	$116,358
Working Hours	1,768	21,215	3,458
Employees Needed	0.8	10.2	1.7
Profitability After Salary	**$42,065**	**$504,784**	**$1,102,392**

By leveraging RiskScout, the institution significantly reduces time for both initial and recurring processes and reduces the number of employees required to perform the task. **The institution was effectively able to more than double their annual profits while only hiring one additional employee.**

Summary

Return on Investment isn't as complicated as it seems, and it's integral to the decision to pursue a new market, product, or service. When considering a new space, determine what the need is, how much of the market you can address, what the addressable market means for revenue, what the cost to your institution is at outset and at scale, and whether the risk adjusted return is adequate. As we say at RiskScout: *Where others see risk, we see opportunity.*

Offer

UBB's partnership with RiskScout will involve direct collaboration between UBB and the high risk banking solution firm to align the needs of UBB's community bank customers with the services provided by RiskScout. **They are offering a complimentary consultation for a BSA Program Checkup, a comprehensive evaluation to help UBB customers evaluate their programs.** The checkup includes:

- Review your latest Audit or Examiner Results, Findings and Recommendations as well as your current BSA Risk Assessment.
- Discuss relevant details of your institution and risk appetite for new markets.
- Present any formal recommendation and suggestions after our conversation.

To learn more, contact your UBB sales representative.

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If you have questions about our products and services, please call us at **1-800-752-8140.**
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