Independent Report
“Colorado banking at its best”
in this issue...

January/February 2019

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Cover by Bob Kissel: Steamboat Springs Train Station, Colorado To see more of Bob’s photos, visit his website at www.flickr.com/photos/rekissel/sets

2018 - 2019 Officers and Directors

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President
Megan Harmon, Branch President & COO, Eastern Colorado Bank

President-Elect
P J Wharton, President, Yampa Valley Bank

ICBA State Director
Tom Chesney, President, AMG National Trust Bank

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John Ezell, Senior Vice President, Redstone Bank
Tom Ogawa, President, Native American Bank, N.A.

District B
Randy Younger, President, First National Bank Hugo
Shawn Osthoff, President, Bank of Colorado
Dan Allen, President, First FarmBank
Ed Rarick, President/CFO, High Plains Bank

District C
Quentin Leighty, CFO, The First National Bank of Las Animas/Monument Branch
Andrew Trainor, Regional President, Legacy Bank
Tony Perry, President, Park State Bank & Trust
Lora M. Rose, CFO, The State Bank

District D
Ed Merritt, Jr., President, Dolores State Bank
Mike Hurst, President, Del Norte Bank
Jay Rickstrew, Regional President, Alpine Bank

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Bill Mitchell, President, Bankers’ Bank of the West
Eric Badreau, Partner, Eide Bailly
Christian Otteson, Shapiro Bieging Barber Otteson
Brian Burke

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Maelynn Lewis, Administration Director, Secretary/Treasurer
Tara F. Hunter, Administrative Assistant

IBC Legal Counsel
Thomas Bieging and John Burrus
Shapiro Bieging Barber Otteson, LLP

IBC Lobbyist
Mary Marchun, The Capstone Group
You may know Bankers’ Bank of the West best as a longtime community bank partner and trusted provider of correspondent solutions, deep expertise and high-touch customer service. In many respects, our team functions as an extension of yours. We demonstrate our commitment to community banking in other ways as well — by participating in industry associations, fostering collaboration among community bankers, and presenting training programs that keep your employees in the know and at the top of their game.

It’s our privilege to support the Independent Bankers of Colorado as its Legacy Sponsor. Let us know how we can help: We’re at your service.

- Loan Participations
- Bank Stock Loans
- ATM/Debit
- Merchant Services
- Operational Services
- Cash Management
- Safekeeping

**Bankers’ Bank of the West**

BBWEST.COM

**WE CHAMPION COMMUNITY BANKING**
IBC has been a leader in webinar training for more than a decade and is committed to superior customer service. Webinars are designed for most positions in a community banks from the frontline to the board room. Speakers are industry experts with long-term, real-life, hands-on experience. Benefits of participating in an IBC webinar include:

- Easy to use, time effective, cost effective, convenient, interactive
- Current and hot topics delivered by experienced speakers
- Take-Away-Toolkit (consists of an employee training log and a quiz to measure staff learning)
- Webinar series specifically developed for: for ACH Specialists, BSA Specialists, C-Suite Executives, Call Report Personnel, Consumer Collection Specialists, Credit Analysis & Underwriting Professionals, Directors, Frontline Personnel, IRA Specialists, Mortgage Lenders, and Regulation E Specialists

### 2019 WEBINARS

**Affordable Professional Training When and Where YOU Choose!**

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<td>8/21/19</td>
<td>E-Compliance Rules, Policies &amp; Best Practices for Email, Web, Mobile &amp; Social Media</td>
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9/19/19 New Compliance Officer Boot Camp
10/3/19 New BSA Officer Training Part 1: Compliance, Risk Assessment, CTRs, Exemptions, Forms & Regulator Expectations
10/17/19 New BSA Officer Training Part 2: Reviews, SARs, CDD, Technical Aspects & Real-Life Scenarios
11/13/19 Year-End Compliance Checklist
11/20/19 BSA Special Risks: Policy, Law Enforcement & Regulator Issues

**DIRECTORS**
3/28/19 Board Reporting Series: Red Flags in Board Reports
6/10/19 Community Bank Mergers & Acquisitions Simplified
6/26/19 BSA Series: Job-Specific BSA Training for the Board
9/25/19 What Directors Should Know About CECL, ALLL & the New Credit Impairment Standards

**FRONTLINE & NEW ACCOUNTS**
1/10/19 Teller Training Series: Compliance Training for the Frontline
1/30/19 Teller Training Series: Frontline Fraud Prevention: Stopping Fraud at the Teller Line
2/20/19 Teller Training Series: Risks & Precautions for Endorsements & Other Negotiable Instruments
3/12/19 Teller Training Series: Cross Selling: The Key to Accountholder Satisfaction & Retention
3/27/19 Handling Power of Attorney & Living Trust Documents on Deposit Accounts & Loans
4/9/19 Teller Training Series: Accurately Completing the CTR Line-by-Line
4/11/19 Notary Essentials & Legalities
5/14/19 Teller Training Series: Managing Dual Control & Cash Limits
6/25/19 Living, Grantor & Family Trust Accounts: Common Problems in Account Opening & Lending
7/1/19 Managing Accounts & Records for Nonresident Aliens: Opening, Identifying, Monitoring & Tax Reporting
7/24/19 Opening Accounts Online: Rules, Risks & Best Practices
8/29/19 Opening Donation, Memorial & Other Accounts for Nonprofit Organizations & Corporations
9/12/19 Managing Minor Accounts: Withdrawals, Transfers, CDD, Closing & Best Practices
10/9/19 Head Teller Training: Maximizing Teller Performance
10/16/19 POD Account Documentation, Compliance, Beneficiaries & Closing
10/22/19 Medallion & Signature Guarantee Risks, Rules & Best Practices
10/30/19 Personal Accounts: Ownership, Authorization, Titling & Documentation
11/6/19 Closing or Changing Accounts for Consumers & Businesses
12/10/19 Business Accounts: Who is Authorized to Open, Close, Transact?

**HUMAN RESOURCES**
6/12/19 Essential HR Recordkeeping from Hiring to Firing
9/24/19 Hiring in the Digital Age: What Every HR Manager Needs to Know About Social Media

**IRA**
1/17/19 IRA & HSA 19 Update, Including Tax Reform Considerations
7/9/19 IRA Series: Processing IRA Rollovers & Transfers
8/6/19 IRA Series: IRA Reporting, Common Issues & Error Resolution
8/27/19 IRA Series: Top 10 Most Misunderstood IRA Issues: Turning Confusion into Confidence
9/16/19 IRA Series: Handling IRA Required Minimum Distributions & Roth Distributions

**INFORMATION TECHNOLOGY**
3/11/19 Synthetic ID Fraud: What It Is, How It Works & Real-Life Scenarios
4/23/19 Hacking the Weakest Link: The Role of Staff in Maintaining IT Security
5/15/19 Hot Issues in Cyber Compliance
6/27/19 Card Data Security: PCI-DSS Risk, Readiness & Compliance
8/15/19 FFIEC Cyber Security Risk Assessments: Policy,
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**Under the New Rules, Effective April 1, 2019**

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**Preferred Providers**

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Happy New Year, community bankers! I hope you all enjoyed the holidays and are ready to start 2019 off right with all that ICBA has to offer. I’m of course talking about advocacy, education and innovation: the three pillars for which ICBA is known. I know many of you are eager to get started on your New Year’s resolutions. And if you haven’t already, I encourage you to also come up with a community banking resolution—one that helps you flourish as a professional.

Regardless of your priorities, I hope you know that ICBA is here for you every step of the way with tools and resources to help you and your bank flourish. Here are some ideas:

**Advocacy:** I encourage you to take advantage of ICBA’s Be Heard grassroots resources. Set a goal to send a grassroots alert every time you see a request from our team either in NewsWatch Today or in your inbox. We moved mountains in 2018 with the passage of the Economic Growth and Regulatory Relief Act (S.2155), but with a new Congress and new staffs to educate on community banking’s priorities, there will be plenty of opportunity this year to flex our advocacy muscles and make more change happen.

**Education:** If you haven’t registered yet for our national convention, ICBA Community Banking LIVE, March 18–22 in Nashville, Tenn., now is the time. You’ll save if you sign up by the early bird deadline on Jan. 25. I look forward to this event every year and have found it to be an incredible opportunity to network with my community banking peers and gain the knowledge I need to stay current. With more than 60 workshops and 10 tracks, you’ll be well on your way to completing your education resolution before spring. And to keep the momentum going, check out what’s available through Community Banker University.

**Innovation:** Last year, ICBA released a Fintech Strategy Roadmap to help you with your innovation planning. (If you haven’t seen it yet, you can do so at [icba.org/fintech](http://icba.org/fintech)) We’re now offering you even more help on this front with the new ICBA ThinkTECH Network, powered by FinXTech Connect. Launching early this year and free to all ICBA members, this directory is the next step in our drive to promote community bank/fintech partnerships (see more on page 72). I wish I had this when I was running my bank! I wish you all a happy and healthy 2019. If there’s anything that we at ICBA can do to make the year more productive on the professional front for you, don’t hesitate to reach out to me or my staff. We’re here to serve you, and we look forward to serving you and your community bank in the year ahead.

Where I’ll Be This Month

I will be at the ICBA ThinkTECH Accelerator in Little Rock, Ark., as we launch the bootcamp phase of the program.

IBC welcomes new associate members: Plante Moran and Golden Eagle Insurance
After a successful 2018, we community banks have another eventful year ahead of us! As we address the challenges and opportunities that await, community bankers can take comfort that our shared values will guide us while we create value that can be shared by the customers and communities we serve. Our shared values transcend politics and are bipartisan at their core.

As we proved with the passage of S.2155, the value of community banking resonates with members of Congress without regard to party affiliation. We leverage this value as we explain to policymakers why what we do is so important. We’ll work to build support and consensus to further our mission of creating an environment where community banks flourish.

While there are thousands of community banks across the U.S., the fundamental values we share remain the same. We operate with the understanding that every local customer and community is unique. We know that the needs of consumers and small businesses can best be met by members of their own communities.

To ensure economic growth reaches every corner of every community, we support a tiered and proportionate regulatory system that recognizes the unique role of community banks. Additionally, there must be fairness in the laws governing our financial services system, which is why we support a level playing field that gives everyone an equal chance to create value.

Community banks’ support for a level playing field coincides with a shared passion for innovation. Community bankers have always been financial services innovators. Our focus on our customers and local communities makes us nimble and responsive to the changes affecting our business. Meanwhile, we will always hold true to our bedrock principle of security and stewardship of our customers’ private information.

The values that community banks share with our customers and communities are fundamental to our success. This is why our business model has worked for more than a century and will continue well into the future. While so much in our business is changing, our shared values and guiding principles don’t change.

I am honored to be a part of that great tradition, and I hope you are too. As we look ahead to another busy year, we can take heart in knowing that a shared set of principles will be there to guide us.

Connect with Tim @TimZimPgh

Did you know?

The nation’s community banks have 52,000 locations across the country and employ 760,000 people.

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IBC Day at the Capitol
Monday, February 25, 2019

The IBC’s Day at the Capitol is a fast-paced, informative, and fun day! Attendees will meet and hear from legislators, visit the Chamber floors, learn about the IBC’s legislative initiatives, why it is imperative to be involved, enjoy lunch with legislators, and more!

New for 2019 – Legislator shadowing! You will be partnered with one of your legislators and “shadow” them for part of the afternoon. Shadowing is a great opportunity to experience the how, what, where, and why of being a legislator.

Mark your calendar to attend this not-to-be-missed event. Additional information will be available soon.
FACTFINDING: KEYSTONE OF PROCESSOR RELATIONSHIP
Mary Brown, VP–Cash management Services, and Marlene Wade, VP–Correspondent Services Bankers’ Bank of the West, IBC Member and Preferred Provider

Finding the best solution for bank processing is a complex and time-consuming process to be sure. Any decision of such importance needs to be thoroughly researched and weighed well ahead of time. Here are a few pointers to get you started.

Assess annually. Conduct a yearly appraisal of your processor’s capabilities. Are they meeting your expectations now? Are they prepared to meet future needs? Make a list of the functions your current system provides along with their value. Review past invoices for accuracy. To get a more detailed picture, you might ask your current vendor if it offers a “best practices” service to identify system capabilities you aren’t using.

Stay up to date. Being aware of what different processors offer is always prudent. Ask colleagues at other banks about their providers. Talk with vendors you encounter at trade shows. Save their literature for future reference.

Allow plenty of lead time. Put contract renewal dates for all agreements and services on your calendar. If you plan on entertaining other options, notify your provider of your intentions, in writing, 24 months before maturity.

Define your priorities. List your main goals. Rank your “must have” capabilities as well any desirable features you’d strongly prefer.

See the vetting process through. Screening prospective providers before requesting a bid for services can save time on everyone’s part. Think through all the ramifications of each proposal you consider. Ask for client references, and check them.

Enlist assistance. Evaluating the intricate facets of processing services is demanding and time-consuming. Vendors vary widely, making it tough to do a side-by-side comparison. Hiring an independent consultant to translate what a provider’s sales rep is saying—or not saying—is often a worthwhile investment.

Leave nothing behind, undefined, or open to interpretation. Processors usually impose steep termination and conversion fees for leaving. Yet those costs are rarely detailed in the agreement. Discuss those penalties up front and insist that they be spelled out. If flexibility and frequent repricing are important, ask for a shorter contract length. Also consider that in the fast-changing ATM/debit processing arena, interchange fee income is a key contributor to the bank’s bottom line—so make that a focus as well.

Negotiate. Template contracts are typically skewed in favor of the processor. However, competition among processors can improve your negotiating position—so by all means, ask for what you want. Lower pricing might be the first negotiating point that comes to mind, but other conditions might be equally (or more) important. You might, for instance, want a single contract expiration date for all your services. Express your priorities. You won’t know which concessions are possible until you ask.

Read before signing. Make sure you understand everything laid out in the contract, even the most minute details. A binding contract is designed to remain intact, after all. Unraveling it is almost always a long, arduous and expensive process. Devoting enough time and attention to the essential groundwork before you sign will go a long way toward building a good working relationship with the service provider you ultimately (and wisely) choose.

The Bankers’ Bank of the West team of correspondent and cash management officers leverages many decades of collective financial services experience in support of community banks throughout Colorado and beyond. If you have a question or request they might help with, please call 303-291-3700. Our mission is to champion community banking.

Don’t miss out on the 2019 Independent Bankers of Colorado Scholarship Competition. See our ad on page XX for more information and visit www.ibcbanks.org/scholarship for full details.
IRA Institute
Thursday and Friday, March 5 and 6, 2019
Eide Bailly Training Room
7001 East Belleview Avenue, Greenwood Village

Ag and Natural Resources Conference
Thursday and Friday, April 4 – 5, Denver
DoubleTree by Hilton
7801 East Orchard Road, Greenwood Village

Ag Credit Analysis
Wednesday, May 22, Denver

BSA/AML Mile High Summit
Tuesday, July 30, 2019
Federal Reserve Bank, Denver Branch, 1020 16th Street, Denver, CO
Andrew Trainor, regional president of southern Colorado’s Legacy Bank and Independent Bankers of Colorado board member, has been selected as a 2019 Inductee into the Pueblo (CO) Hall of Fame sponsored by The Pueblo Community College Foundation. Each year the Foundation selects inductees from among nominations submitted. The Hall of Fame was established to honor individuals who, by their extraordinary efforts, have contributed to the betterment or enhancement of Pueblo.

Trainor, has been Legacy’s regional president since 2004 and during that time has led the bank’s expansion from one location to seven in Pueblo, Canon City, Colorado Springs, Lamar and Wiley. In addition to providing valuable banking services, he attributes the bank’s successful growth to its philosophy of building a presence in the communities it serves through a continuing series of public service initiatives that in turn support programs that benefit others. Trainor noted that personal commitment to community involvement stems from his belief that community is at the core of everything we do and that sharing gifts – whether time, talent or resources – is vital to individual and community growth.

Personally and professionally, Trainor is a committed supporter of higher education in Pueblo. Through his efforts, Legacy Bank provided a matching grant to start the Return to Earn scholarship program at Pueblo Community College, a program that provides scholarships for students who left PCC before graduation for personal or financial situations but wish to re-enroll and earn their degrees. Students in this program had a 97 percent retention rate and in two years, 113 students graduated from PCC. He also serves on the board of the CSU-Pueblo Foundation, the school from which he was graduated and Legacy has provided financing and funding for multiple CSU-Pueblo projects. The bank support of education has been prominent among the more than 300 such programs it has supported in the communities it serves.

The list of Trainor’s personal community service activities is extensive. He has served on the board of directors of the Pueblo Economic Development Corporation since 2014 and is its current chairman. He also serves as an elder at Fellowship of the Rockies and has taken the lead role in the development of the Pueblo Del Sol subdivision, which will provide a new site for the church and more than 100 new homes for the Pueblo community.

“Being an inductee into the Pueblo Hall of Fame is such an honor,” said Trainor. “Personally and professionally, we try to live by three things – what’s right, what builds up others, and what represents us as a person of faith. To be honored for executing those types of principles is humbling.”

Trainor graduated from CSU-Pueblo and The Graduate School of Banking at Colorado. He began his banking career in 1981. He and his wife, Donna, have three children and four grandchildren.

The induction of Trainor and two other individuals being so honored will take place Feb. 16 in PCC’s Fortino Ballroom, 900 W. Orman Ave. The evening will begin at 5:30 p.m., with dinner at 7 and the ceremony at 8.

Congratulations Andrew!
When Signed into Law, the 2018 Farm Bill would Legalize Certain Hemp and Hemp Products that Meet the Statutory Definition (“Hemp”) – Remove “Hemp” from Schedule I of the Controlled Substances Act

On November 29, 2018, the Senate and House Agriculture Committee Chairs announced that the Conference Committee reached agreement on the Agriculture Improvement Act of 2018 [H.R. 2] (the “2018 Farm Bill”) after months of negotiations. On December 10, 2018, the Conference Committee released the bill text in its Conference Report¹. Floor votes in the House and Senate are expected on Thursday, December 13, 2018. In anticipation of its passage, we drafted the following summary of the key provisions in the 2018 Farm Bill that address “Hemp” and how it would be regulated.

A Bit of History . . .

A key aspect of the 2018 Farm Bill (and a pet issue for Senate Majority Leader Mitch McConnell of Kentucky) related to the legalization of hemp, which for many years was listed as a Schedule I Narcotic under the Controlled Substances Act. Back in 2014, that version of the Farm Bill authorized limited agricultural pilot programs as well as academic research into the production of “industrial hemp” subject to State licensing (the “2014 Pilot Programs”). However, these 2014 Pilot Programs were narrowly construed by various federal agencies, including the Drug Enforcement Agency or DEA, who interfered with legal industrial hemp production in the State of Kentucky, which drew the ire of Senators McConnell and Paul of Kentucky.² The 2018 Farm Bill provisions related to hemp production are meant to fully legalize production of “Hemp” as defined under Federal law (the definition is the key).

To be Considered Legal, “Hemp” must have not more than 0.3 THC on a dry weight basis

Section 10113³ of the 2018 Farm Bill defines “Hemp” to mean, “the plant Cannabis sativa L. and any part of that plant, including the seeds thereof and all derivatives, extracts, cannabinoids, isomers, acids, salts, and salts of isomers, whether growing or not, with a delta-9 tetrahydrocannabinol concentration of not more than 0.3 percent on a dry weight basis.”⁴ Section 12619 of the 2018 Farm Bill clarifies that “Hemp” that meets the definition quoted above is: (1) not included within the Controlled Substances Act’s definition of “marihuana”; and (2) is not on the Schedule I narcotics list under the Controlled Substances Act. However, an important implication is to understand that hemp (and derivatives, extracts, cannabinoids, isomers, etc.) with more than 0.3 percent THC on a dry weight basis continues to be illegal.

A State or Indian tribe desiring to have primary regulatory authority over the production of “Hemp” in the State or territory must submit a “plan” to the US Secretary of Agriculture describing how the State or Indian tribe monitors and regulates the production of “Hemp”. The “plan” must be submitted through the State Department of Agriculture in consultation with the Governor and the chief law enforcement officer of the State and the US Secretary of Agriculture has 60 days to review the plan in consultation with the Attorney General. The US Secretary of Agriculture has the sole authority to issue Federal regulations and guidelines that relate to the production of “Hemp” and State and Tribal “plans”.

IBC COMPLIANCE UPDATE:

Hemp and the 2018 Farm Bill

The 2018 Farm Bill clarifies that the US Secretary of Agriculture may award grants and enter into agreements or other arrangements to conduct research related to the development of Hemp as well as the development of new and emerging commercial products derived from “Hemp” and appropriations were included in the bill. Conforming changes were made to make “Hemp” an agricultural commodity and an insurable crop, providing insurance options for “Hemp” producers.

Section 10114 also clarifies that nothing in the title authorizes interference with the interstate commerce of “Hemp”, including the transportation of “Hemp” and “Hemp” products through a State or an Indian Territory. This provision was no doubt important to the Senators from Kentucky.

Within 12 months of enactment of the 2018 Farm Bill, the US Secretary of Agriculture must conduct a study of the various 2014 Pilot Programs previously authorized by States, including the economic viability of the domestic production and sale of hemp and report the results to Congress.

Finally, one year after the US Secretary of Agriculture establishes the “plan” requirements for States and Indian territories under the 2018 Farm Bill, the statute establishing the 2014 Pilot Programs will be repealed.

¹ https://docs.house.gov/billsthisweek/20181210/CRPT-115hrpt1072.pdf
² https://www.huffingtonpost.com/2014/05/13/dea-seizes-kentuckys-hemp_n_5318098.html
³ Section 10113 of the 2018 Farm Bill adds a new Subtitle G – Hemp Production to the Agriculture Marketing Act of 1946 [7 U.S.C. 1621 et seq.].
⁴ Tetrahydrocannabinol is also referred to as THC.
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Over the past 30 years, Travelers Financial Institutions Property & Casualty business unit has distributed to eligible member banks more than $50 million in total dividends. Member banks may become eligible for the program by purchasing qualifying Travelers property and casualty* and workers compensation coverage. Beyond policy benefits, you get industry-leading information for managing risk and an opportunity to earn a “safety-group” dividend payout, an incentive made possible by the group’s favorable loss experience.**

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*All property casualty coverages may not be available in certain areas; and umbrella, mail and equipment breakdown coverages are not eligible for dividend payout.

**Dividends are not guaranteed and are subject to the approval of the company’s board of directors.
REAL ESTATE DEVELOPMENT LENDING IN COLORADO:
THE USE OF SPECIAL DISTRICTS FOR REAL ESTATE DEVELOPMENT IN COLORADO AND LENDER RISKS AND CONSIDERATIONS (PART 2 OF 2)

By Jeffrey E. Erh, Esq. – Seter & Vander Wall, P.C.

Bank Owned (REO) Development Projects

When a development does not go as planned, the development lender may end up owning all or part of the real estate. While owning a large piece of undeveloped or partially developed property presents its own challenges, an additional layer of complexity is added when a special district also exists on the property.

Operation of the Special District. Because special districts are governed by a board elected from residents or property owners within the special district, a lender may discover that not only has it taken over ownership of the property, but it has also become responsible for the operations of a special district as the sole or primary property owner. Operating a special district involves compliance with annual legal matters including preparation and filing of an annual budget, maintaining insurance, and conducting director elections. If the special district provides ongoing services or has outstanding debt, these operating requirements may also include providing those services, imposing taxes and fees, and ensuring compliance with the terms of any bond covenants or other debt. The lender may be responsible for the operation of the special district for years before the property can be sold.

The operation of the special district can be further complicated if the development project is partially completed, resulting in additional property owners within the special district who may not have the same goal as the bank lender to see the remaining property develop or have the special district issue debt to finance additional public improvements. Successfully managing this public relations challenge can be the key to a profitable sale of the property and ultimate recovery of the loan amount.

The Special District as an Asset. The special district can be marketed as an asset during the marketing and sale of the bank owned property. The creation of a special district is an expensive, time consuming, and often politically charged process. Instead of being required to create the special district on its own, a new developer obtains the benefit of a special district already in place to assist with the financing of the public improvements. This has a direct impact on a potential developer’s development cost and ultimately the amount of money willing to be paid for the property.

In addition, the special district may already possess valuable means to help with the successful development of the property, such as an ability to provide water or sewer service to the development, the existence of a tax or fee revenue stream to assist with operating expenses, governmental funds available for new public improvements, or access to the tax-exempt loan market. The benefits provided by the special district can significantly improve the marketability and value of the property for sale to a future developer.

Risks. Often, the lender takes ownership of property from a defunct real estate developer without obtaining control of the special district. At times, the defaulting development entity may retain control of the district by continuing to have representation on the board of directors. In that event, the defaulting developer may control the district board of directors, and consequently control the taxation and imposition of fees on the property now owned by the lender. Special district taxes and liens enjoy priority treatment over other liens and encumbrances under Colorado law. For example, special district fees benefit from a statutory lien that cannot be discharged and, if not paid, can be collected by the special district through foreclosure of property. The fees could be imposed in such a way that the property is rendered valueless for development, leaving the bank property owner with the challenges of recovering the value of its property, sometimes involving litigation to dispute the fee. A similar scenario occurred in Douglas County, Colorado, where a former developer, through a contract with a special district previously used by the developer for financing purposes, retained the right to receive special district fees and asserted that interest was owed on those fees. The fees and asserted interest were a lien against property owned by a bank which obtained title through a foreclosure. The fees and interest claimed exceeded the value of the property and as a result rendered the property valueless to the bank.

In addition, the defaulting developer may use its ability to control the special district to issue debt to fund obligations owed to the developer under existing acquisition agreements (see Part I), with such debt expenses being paid by the property owners (the bank). In addition, the developer may use its control of the special district to engage developer-owned companies to operate the district, raising questions of conflicts and self-dealing, or the developer may use the special district to impede the sale and development of the property by imposing fees or rules that effectively reduce the value of the property or increase the difficulty of development to a level that is unacceptable for a prospective developer.

Each of these risks are real and have occurred in Colorado. Through thoughtful planning at the lending stages and with an understanding of how special districts work and are used by

Continued on next page
developers, a real estate lender can take steps to mitigate its risks and maximize its chances of recovery in the event of a default.

**Conclusion**

Banks making development loans should understand and closely monitor the developer’s intended use of special district financing for the project from the inception of the loan, during the construction process, and through final payoff to ensure loan collateral is protected and maximized. Assignment to the lender of the developer’s right to have the infrastructure purchased by the special district is one tool that can help reduce the risk of non-payment in the event of a defaulting borrower. In the event of a default or failed development, effective use and management of the special district to protect the value of the property is important to maximize recovery. By working with the developer and engaging legal counsel to assist in the process, both the developer and lender can craft a loan package that will lead to a successful loan and development.

For more information, contact Jeffrey E. Erb, Esq. (303) 770.2700 / j erb@svwpc.com
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However you slice it, municipal bonds have a big impact on community bank investment performance. Even if you don’t own any. That’s because your bank’s collection of bonds is destined to be in the bottom of the rankings amongst its peers, unless you own some.

This of course is not news. For decades, a hallmark of high bond portfolio performance is a large weighting of tax-free securities. Among the investments that community banks are permitted to own, munis tend to be the highest yielding. There are several reasons for this.

One is that they’re not guaranteed by the federal government or one if its agencies. (That doesn’t necessarily indicate they don’t have really good credit quality.) Another is that munis have a limited supply, which could mean they have a scarcity value that makes them expensive, but instead means they have somewhat lesser liquidity than other sectors. Most importantly, they have the longest durations of any category in the portfolio, which is mainly a function of a perpetually steep yield curve.

Latest rankings
Remember also that the yield your bank earns on its tax-free securities is driven by its marginal tax bracket. The higher the tax rates, the bigger the tax-equivalent yields. This means S Corporations have higher yields on their munis than do C Corporations, although all tax-advantaged assets have seen their yields drop since the Tax Cuts and Jobs Act went into effect in 2017.

For example, a C Corporation that owned a muni at a tax-free yield of 2.75 percent prior to tax reform would have been booking a tax-equivalent yield of about 4.17 percent. Now that same bond’s tax-equivalent yield is about 3.45 percent. For S Corporations, the drop is similarly painful: from about 4.55 percent to 3.87 percent.

In response, banks have been right-sizing their muni holdings. For the one-year period ending Sept. 30 2018, the typical community bank bond portfolio decreased its muni sector weighting from 28 percent of the total to 23 percent. It’s likely more shifting will occur as bonds get called and mature.

Legislation implications
The 2017 Act will impact also municipal supply in the coming years. Attendant to tax reform was the elimination of the ability for muni issuers to “pre-refund” their outstanding debt any longer than 90 days before their call dates. Prior practice saw bonds being issued as long as three years in advance of outstanding issues they were to replace. What this meant for muni issuance in 2018 is that only about 31 percent of 2018-dated bonds were for refinancings of older bonds. That number was 74 percent just two years ago.

Also, the largest two years of muni issuance in history were 2009 and 2010 as the American Recovery and Reinvestment Act (ARRA) of 2009 created several new classes of municipal bonds, and expanded the size limit for Bank Qualified bonds. These provisions only applied to those issued in the two years, so there was a lot of paper printed in that time frame. Many of the longer-dated maturities had ten-year call provisions embedded in them, which means that 2019 and 2020 will see a lot of bonds get called. Also, the entire muni market globally has been stuck at about $3.7 trillion for the last five years, and there are actually fewer bonds outstanding now than in 2010.

Built in demand
Ironically, even though banks are shedding some of their munis, and muni issuers are going to be shrinking some of their older outstandings by calling them away, there should be decent liquidity and stability to the muni market. A lot of this is owing to robust demand from the retail sector, which owns about two-thirds of all municipal bonds. Individual tax rates didn’t change much in the 2017 Act, so those individuals’ tax-equivalents didn’t change much either.

To be sure, banks have plenty of income these days to shield from the tax man. Industry earnings were up year-over year by more than 30 percent through Sept. 30. By most indications, 2019 should be a solid year for community bank performance. You can help ensure it by actively managing and updating your municipal bond holdings to fit your institution’s needs.

Jim Reber can be reached at (800) 422-6442 or jreber@icbasecurities.com.
A POWERFUL WEAPON IN THE WAR FOR DEPOSITS

By Glenn Martin, Managing Director, Promontory Interfinancial Network, LLC, IBC Associate Member

If you look at financial news headlines or results from Promontory Interfinancial Network’s latest Banking Executive Business Outlook Survey, it has become clear that the competition for deposits is reaching highly competitive levels, forcing banks of all sizes to consider new strategies that position them favorably as interest rates continue to rise and the regulatory environment transitions.

Some say this environment could bring about a war-like scenario. Deposits were plentiful during the decade following the financial crisis, when customers shifted to cash positions. That trend is beginning to reverse itself, but in a slightly different way, as more deposits begin to leave institutions that long held them. As the No. 1 provider of Federal Deposit Insurance Corp.-insured deposit sweep services and a partner to thousands of banks across the country, we hear this from banks all the time.

Some advice on strategy development was shared during a recent webinar hosted by Promontory Network and Bank Director. The webinar featured insights from representatives of Farin and Associates, Sandler O’Neill + Partners and Darling Consulting Group.

Key points that came from the webinar included:

- Don’t fixate too much on interest rates. Instead, dive deeply into your current deposit base and study it to develop more meaningful long-term strategies. Rates are important, but they should be a guide for goals, not the only factor.
- Deliver products that your customers want. Many banks offer money market accounts which customers want, but sometimes, the pricing has not been reconciled with the current market, and that can make a difference. Also, if your bank’s deposit products are not going to satisfy its asset and liability management goals, consider developing more attractive products.
- Think long term. It’s easy to be consumed by the short-term growth or retention of deposits or overall cost of funds, but a long game should be played as well for the stability and longevity of the institution. Considering how short-term objectives play into long-term goals and successful strategies can make a big difference.

Since the webinar was held, a new opportunity to help banks compete for retail deposits has emerged from one of the lesser-known provisions put in place through the Economic Growth, Regulatory Relief, and Consumer Protection Act. And it can help banks that utilize reciprocal deposits immediately. Specifically, the act changed the classification of most reciprocal deposits so that they are no longer considered brokered.

Reciprocal deposits are deposits that a bank receives through a deposit placement network in return for placing a matching amount of deposits at other network banks. Placing funds using a deposit placement network enables a bank to accept and help make eligible for FDIC insurance deposits beyond the standard $250,000 by dividing and distributing the deposits to other banks in the network, while at the same time receiving an equal amount of deposits from other network banks that are doing the same thing with their customer funds. Banks that use reciprocal deposits can enable a large, local depositor to access multi-million-dollar FDIC protection while developing more local relationships than they otherwise might and using the underlying deposits to fund more loans.

Banks can take advantage of the new treatment of reciprocal deposits by:

- Seeking more large-dollar, locally-based customers that they may have been hesitant to approach before
- Attracting more large-dollar deposits from locally-based businesses and other types of customers that may be keeping their deposits with larger banks that they perceive as “too big to fail”
- Replacing higher amounts of more expensive collateralized deposits
- Replacing higher amounts of more expensive, less stable listing service deposits
- Replacing higher amounts of wholesale funding
- Pursuing more government and financial institution deposits as the nation’s largest banks—which are subject to liquidity coverage ratio calculations—look to shed these deposits, providing an opening for community banks to win these deposits and to go after the whole banking relationship
- Locking in more low-cost funding now as a hedge against higher rates in the future, recognizing that large deposits from institutional investors are good targets for banks looking to take advantage of the low deposit betas associated with reciprocal deposits and to secure customers for longer terms

The bottom line is that the battle for deposits is intensifying, making now the time to discuss what success looks like and to determine the best strategy to get there.

To learn more about the reciprocal deposits provision enacted in the regulatory relief package signed in May, visit www.promnetwork.com/no-longer-brokered or contact Glenn Martin at gmartin@promnetwork.com
IS THAT YOUR PAPER?

DETERMINING EMPLOYEE ENGAGEMENT

By Connie West, Regional Vice President, The James Paul Group, IBC
Associate Member

You’re walking down the hallway and you see some paper on the floor.

It’s just a gum wrapper. What do you do? Pick it up? Walk on past?
Or were you the one who dropped it in the first place?

Employee engagement is a measurement of how enthusiastic an employee is about their job. Gallup defines employee engagement as 3 segments, Engaged, Not Engaged and Actively Disengaged:

**Engaged Employees** are highly involved in and enthusiastic about their work and workplace. They are psychological “owners,” drive performance and innovation, and move the organization forward.

**Not Engaged Employees** are psychologically unattached to their work and company. Because their engagement needs are not being fully met, they’re putting time — but not energy or passion — into their work.

**Actively Disengaged Employees** aren’t just unhappy at work — they are resentful that their needs aren’t being met and are acting out their unhappiness. Every day, these workers potentially undermine what their engaged coworkers accomplish.

We need fewer “not engaged” or “actively disengaged” employees to drive bank results and most importantly, customer satisfaction.

So, how did you answer the questions above? The Engaged Employee would stoop and pick up the paper they see in the hallway. The employee who’s Not Engaged would walk right over it since it’s not their problem. And finally, the Actively Disengaged Employee is the one who dropped it there to begin with.

To learn more about Employee Engagement, contact Connie West at The James Paul Group, cwest@jamespaulgroup.com, or toll free at 877-584-6468

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Jim Clifton, Gallup Chairman and Ceo

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On May 8, 2018, President Trump announced his decision to withdraw the United States from the Iran Deal, also known as the Joint Comprehensive Plan of Action (JCPOA), a treaty implemented on Jan. 16, 2016. Joined by Iran, China, France, Germany, Russia, the United Kingdom and the United States, the JCPOA allowed sanctions relief to Iran in exchange for curbing its nuclear-related programs.

In conjunction with Trump’s decision, the U.S. reinstated nuclear sanctions on Iran at the conclusion of two wind-down periods, the second of which ended Nov. 4. The wind-down allowed U.S. organizations time to wrap up all soon-to-be sanctioned transactions with Iran.

According to the Treasury Department, “Persons engaging in activity undertaken pursuant to the U.S. sanctions relief provided for in the JCPOA should take the steps necessary to wind down those activities … to avoid exposure to sanctions or an enforcement action under U.S. law.”

The re-instated sanctions cover various types of transactions with Iran in the energy, shipping and banking sectors, including the purchase or acquisition of U.S. dollar banknotes by the Government of Iran; sanctions on petroleum-related transactions, including the purchase of petroleum, petroleum products or petrochemical products from Iran; the provision of underwriting services, insurance or reinsurance; and transactions by foreign financial institutions with the Central Bank of Iran and other designated Iranian financial institutions.

According to an Op-Ed in the Financial Times by U.S. Treasury Secretary Steven Mnuchin, “These actions are an important step towards holding the world’s largest state sponsor of terror accountable for its malign behaviour, human rights abuses, ballistic missiles development, and systematic efforts to exploit the global financial system to fund its revolutionary ambitions.”

What Does This Actually Mean?
Perhaps the biggest and most significant aspect of our country’s Iran Deal withdrawal is the re-instatement of a substantial subset of Iranian names and entities to OFAC’s Specially Designated Nationals (SDN) list, those whose assets are blocked and with whom U.S. persons are prohibited from engaging in activities or transactions.

What this signifies is an enormous update, all at once, to OFAC’s SDN list. By now, all U.S. financial institutions and organizations should have—or must immediately—perform a customer database re-screen to ensure they’re not conducting business with re-instated SDNs. For organizations that do not employ automated watch list screening, this task can seem practically insurmountable from a cost and time standpoint.

What Should Institutions Do Now?
Conducting sanctioned transactions or certain activities with SDNs can mean business-crushing fines by OFAC. In fact, the number of million-dollar civil money penalties has grown exponentially over the last few years. U.S. financial institutions—and all other organizations, for that matter—should:

- If not already doing so, strongly consider implementing automated watch list screening. Trying to manually handle such an enormous update workload can easily overwhelm compliance staff and leave too much room for human error.
- If there’s no doubt your institution has recently conducted transactions with Iranian companies or individuals, ensure you cease any further transactions and re-screen your customer database.
- Review policies and procedures, particularly those that might have allowed the types of transactions in question.
- For non-U.S. subsidiaries of U.S. institutions, terminate any transactions with Iran.
- Maintain an overall awareness that these actions by the Trump administration might just be the tipping off point for further events that may greatly affect the country as a whole—well beyond financial transactions.

Secondary Sanctions
Currently, the U.S. is the only country to withdraw from the Iran Deal, a fact that potentially complicates our relations with the remaining countries involved in the JCPOA, due to what’s called secondary sanctions. Secondary sanctions come into play for cases in which the U.S., another country, and Iran were involved in business dealings prior to our withdrawal from the deal—and the other country continues those dealings with Iran.

For example, if the U.S. conducted transactions with France and Iran involving goods and services used in the Iranian automotive industry—and France continues those transactions that the U.S. has now sanctioned—France could be subject to secondary sanctions. These sanctions can lead to commercial and legal risks.

What’s Next?
That’s the million-dollar question. Unfortunately, the answer is “wait and see.” However, if this presidential administration continues on its current course, Iran sanctions could be just the beginning. In fact, relations with a huge petroleum supplier, Saudi Arabia, appear less than solid following the death of journalist Jamal Khashoggi.

For now, it’s vital that financial institutions and all other American businesses remain solidly aware of how this action plays out. And of course, screen and re-screen all customers. For much more on this topic, listen to the Iran Sanctions episode of CSI’s podcast, Fintech Focus.

Amber Goodrich, compliance strategist for CSI Regulatory Compliance, has more than 10 years of financial industry experience. She is a Certified Regulatory Compliance Manager (CRCM) and Certified Bank Secrecy Act (BSA) Professional (CBAP).
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Initial coin offering. Blockchain. Bitcoin. Crypto Coin. Ethereum. Token. Ecosystem. Whitepaper. Distributed ledger technology. All very exciting; all very modern; all very shiny. And each of those terms, and many more like them, should spell “C A U T I O N” to any banker.

Financial technology, or fintech, appears to be taking the financial world by storm; seemingly threatening the very ongoing existence of community banks. Bankers are constantly reading about these new technologies, and hearing about them at conventions and seminars. It seems the ever present message is: join in the fray or be left behind. But with that advice comes one more bit of advice—be careful. For just as a rose has fragrance, it also has thorns.

Initial coin offerings, or ICOs, have recently become a thorny issue for sponsors who did not heed to warnings of potential regulatory issues. But, first things first, what is Blockchain?

Blockchain technology is a distributed ledger, allowing access to digital records maintained on a decentralized basis in a standardized format. Blockchain allows for a secure, immutable audit trail that is time-stamped and that can be viewed simultaneously, but not changed, by multiple parties. Each “block” in the blockchain may be a unit of value, like Bitcoin or Ether, or contain other information, such as a smart-contract or health records.

Initial coin offerings have been around since 2013. ICOs have recently become a popular way of raising capital; real dollars or digital assets (such as Bitcoin or Ether) are exchanged for the offered crypto coins or tokens. Using blockchain, those skillful with computers can create their own digital assets, with the hope that their crypto coin or token becomes the next Bitcoin. Similar to stock offerings, ICOs typically raise money through the on-line distribution of so-called “whitepapers” that describe the individuals involved in the project and the project and ecosystem they intend to develop. On the one hand, these offerings enable companies to raise a significant amount of capital; on the other hand ICOs have led to class action lawsuits and garnered the (unwanted) attention of the Securities and Exchange Commission (the “SEC”).

In the last few years the SEC has issued several warnings regarding various aspects of digital assets and related technology, and very recently the SEC initiated enforcement actions against sponsors of two ICOs. Through these enforcement actions and pronouncements, including its “Statement on Digital Asset Securities Issuance and Trading” (the “Statement on Digital Assets”) issued in November 2018, the SEC has made clear its position: tokens, crypto coins, and other forms of digital assets issued through ICOs may constitute securities under federal securities laws, resulting in the issuance, trading, and exchange of such digital assets being subject to securities regulation.

Under federal securities laws, the term “security” includes investment contracts. The United States Supreme Court has defined an investment contract as a contract, transaction, or scheme whereby a person invests money in a common enterprise with the expectation of profits derived from the efforts of the promoter or a third party. In the SEC’s view, the offering of digital tokens, coins, or other forms of digital assets may constitute an investment contract and thus a security. If deemed a security, the offering of a digital asset must either (1) be registered with the SEC or (2) fit within an exemption from registration. The failure to meet either of those two alternatives results in the offering violating the registration requirements of the Securities Act of 1933.

In its Statement on Digital Assets the SEC further noted that vehicles involving the investment in digital assets (such as funds), and those who advise such vehicles, may be regulated under the Investment Company Act of 1940 and/or the Investment Advisers Act of 1940. In addition, platforms for the secondary trading of these digital assets may be subject to regulation as broker/dealers or securities exchanges under the Securities Exchange Act of 1934.

Setting aside the possibilities of a community bank engaging in an initial coin offering or trading in digital assets, should there be concern? Yes. It is not a stretch to foresee community bank customers in the near future will demand that digital assets be incorporated into the products and services they receive from their bank. For example, customers may want to borrow funds to purchase digital assets or may want to provide collateral for loans by pledging digital assets. Both of these interactions with customers come with associated risks that will require attention.

In November 2018 the SEC announced two consent orders involving ICOs. The SEC imposed substantial civil money penalties upon the sponsors, required registration of the digital assets with the SEC, and demanded that the sponsors offer rescission to investors (although it is unclear if the sponsors have the wherewithal to honor such offers). Taken together, these enforcement tools could threaten the stability of just about any token, coin, or other form of digital asset purchased or owned by customers.

Thus, when a bank’s customer invests an imprudent amount in digital assets, through ICOs, secondary trading, or otherwise, their ability to repay a loan may become imperiled if the underlying digital asset’s value evaporates. Or, if a customer offers digital assets as collateral for a loan, the value of the collateral may be imperiled. In fact, the value of even the most well-known of digital assets—Bitcoin—has been volatile recently, reaching a high value of more than $17,000 in January 2018 and closing out 2018 at just over $3,800. And none of Bitcoin’s volatility can be traced to the concerns that an ICO raises. Furthermore, even if the value of a digital asset remains stable, the ability to sell such an asset may be difficult or expensive given the attendant securities laws issues and the problems that arise from small, illiquid markets that exist for most such assets.

So, when it comes to digital assets, be careful out there. ■

Address questions or comments to lharris@polsinelli.com or dallred@polsinelli.com.
THE “PASS-THROUGH” DEDUCTION DOESN’T REQUIRE A PASS-THROUGH

By Eric Budreau, CPA, Tax Partner, Eide Bailly LLP, IBC Associate Member

The “Qualified Business Income” deduction, a new tax break for certain businesses, allows qualifying individuals and trusts to potentially deduct up to 20 percent of their net business income from taxable income.

Recent tax reform legislation reduced the top corporation tax rate from 35 percent to 21 percent. That corporate reduction prompted “pass-through” businesses to lobby for their own tax break. The QBI deduction was the result, which prompted many taxpayers to refer to it as the “Pass-Through Deduction.

Unfortunately, that nickname has led many taxpayers to believe the QBI deduction is only available if the income is earned by a “pass-through entity,” such as an S corporation, partnership or LLC. But, that’s wrong. While there are limitations related to business type and amounts earned, most business income reported on a Schedule C, Schedule E or Schedule F is potentially eligible for the deduction; it doesn’t need to arise in a pass-through entity nor be reported on a Form K-1.

There may be a lot of good business reasons to use a pass-through entity but being eligible to benefit from a QBI deduction (or the “Pass-Through Deduction” for some) isn’t necessarily one of them. Contact Eric Budreau at Eide Bailly to find out what you really need to know and do in order to qualify for this valuable deduction.

For more practical insights on tax reform, visit us at www.eidebailly.com.
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**LOCATIONS**

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For information about how your bank can join our network, please call Lauren Gonnella Copeland at 513-900-4661 or lauren.gonnella@vantiv.com!