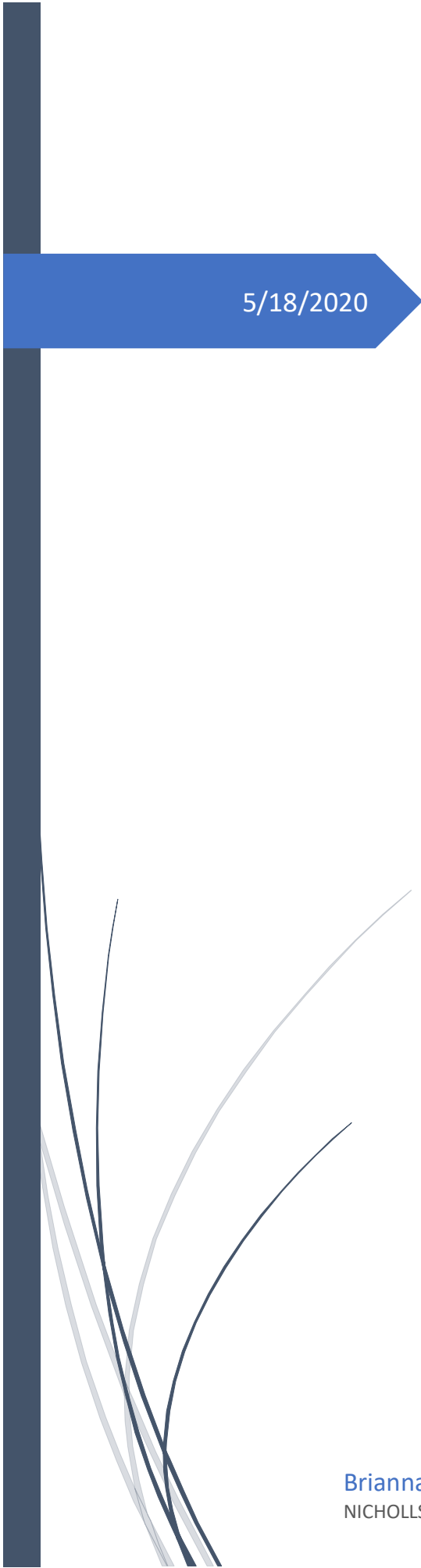




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United Community Bank

Community Bank Case Study

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Introduction

United Community Bank was established in 1964 in Lafourche Parish. United Community Bank is a full-service financial institution that focuses on a commitment to providing local people with a personalized service. Over time United Community Bank has expanded to servicing Terrebonne, Ascension, St. John the Baptist, and East Baton Rouge parishes (Board & Executive Management).

For the United Community Bank case study, we will be providing a financial analysis of the bank's earnings performance, loan portfolio composition, asset growth, capital levels, and liquidity over a five-year period from 2015 to 2019. We be will discussing United Community Bank's overall compliance with the Bank Secrecy Act and Anti-Money Laundering Act. Furthermore, we will be discussing the bank's use of technology, innovations, and any collaborations between other banks. Finally, we will be discussing United Community Bank's policy recommendations for the regulators of the Bank Secrecy Act and Anti-Money Laundering Act.

Executive Summary

United Community Bank is a full-service financial institution, established in 1964, that focuses on a commitment to providing local people with a personalized service. In order to efficiently and effectively provide these services, certain regulations must be followed. The Bank Secrecy Act and Anti-Money Laundering Act were put into place to protect consumers by detecting fraud, laundering, or events where large amounts of money are used to pay for other illegal acts that could be potentially harmful to consumers throughout the nation (Bank Secrecy Act (BSA)).

We first looked at the financials of United Community Bank from 2015 to 2019. The financial analysis reveals that United Community Bank's earnings performance has risen 389.24% over this five-year period. While their loan portfolio primarily consists of real estate (59.2%) and commercial/industrial loans (19.9%), United Community Bank's asset growth has maintained a gradual upwards climb from \$532 million assets to \$546 million assets.

United Community Bank upkept the necessary capital levels to be considered well-capitalized, even with the costs needed to comply with the BSA/AML regulations. This is a demanding task that requires training, detail, and focus on the employees' part such as proper and detailed documentation, and more. These processes can be costly to an institution as approximately 0.85% of non-interest expenses are accrued due to BSA/AML compliance efforts. Currently, BSA/AML compliance reviews make up 24.2% of the total compliance and external audit expenses. Management believes that their current processes are about as cost-efficient as they can be, but they may look into internal staff completing further reviews and tests in order to look into where expenses may be decreased.

Numerous programs and software have been developed to help with BSA/AML compliance. United Community Bank has not been actively searching for new technology to meet BSA/AML requirements because they currently use a program called Financial Crime Risk Management, which is run by their core system called Fiserv. This program allows for real time detection of fraud and reduces false positives, which improves regulatory and operational efficiency while giving a holistic view across all the potential financial crimes, locations, and channels.

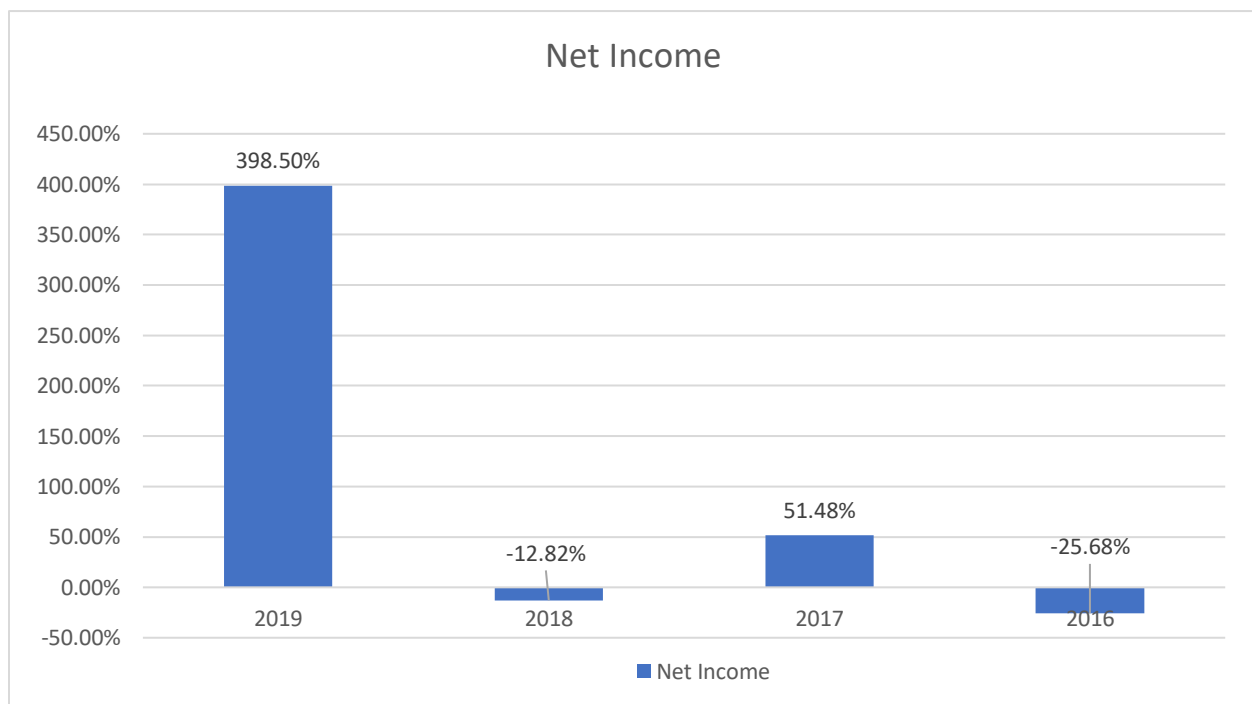
United Community Bank's interactions with FinCEN and the regulators have gone well up to this point in time. However, they do think it is necessary for the regulators to have a little more training as some of the regulators struggle after major changes in the laws for BSA/AML occur. This is just one recommendation that United Community Bank has suggested. United Community Bank would also like to receive preliminary guidance before new statutes are enacted into law, which could significantly reduce costs for both the financial institutions and the federal regulators as it eliminates trial and error costs of repeated inspections.

United Community Bank's key recommendation, however, is to modernize the BSA/AML is to account for inflation in currency transaction reports. Currently, currency transaction reports must be filed if cash transactions over \$10,000 are conducted by, or on behalf of, one person, as well as multiple currency transactions that aggregate to be over \$10,000 in a single day (CTR Reference Guide). United Community Bank recommends that the cash transaction trigger should be increased to at least \$25,000 to induce a significant savings of time and resources. Overall, maintaining open communication between the regulators and the local community banks will help ensure that small communities may thrive.

Part 1: Financial Analysis

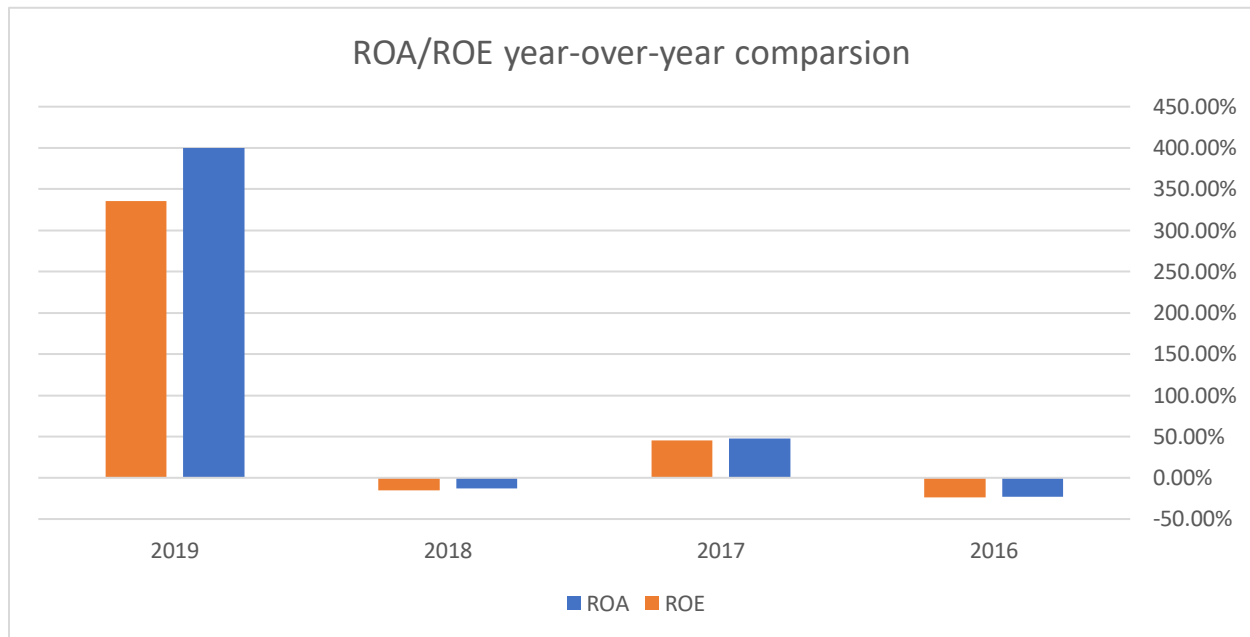
Earnings Performance

United Community Bank's net income was stable between 2015-2018 but saw an increase in 2019. The net income grew from \$2.04 million in 2015 to \$10 million in 2019. This was an increase of 389.24% over the five-year period. The growth occurred due the total interest income increasing by \$5.65 million, total noninterest income increasing \$3.98 million, and additional noninterest income increasing by \$4.06 million. The following graph shows the year-over-year change in net income for United Community Bank.



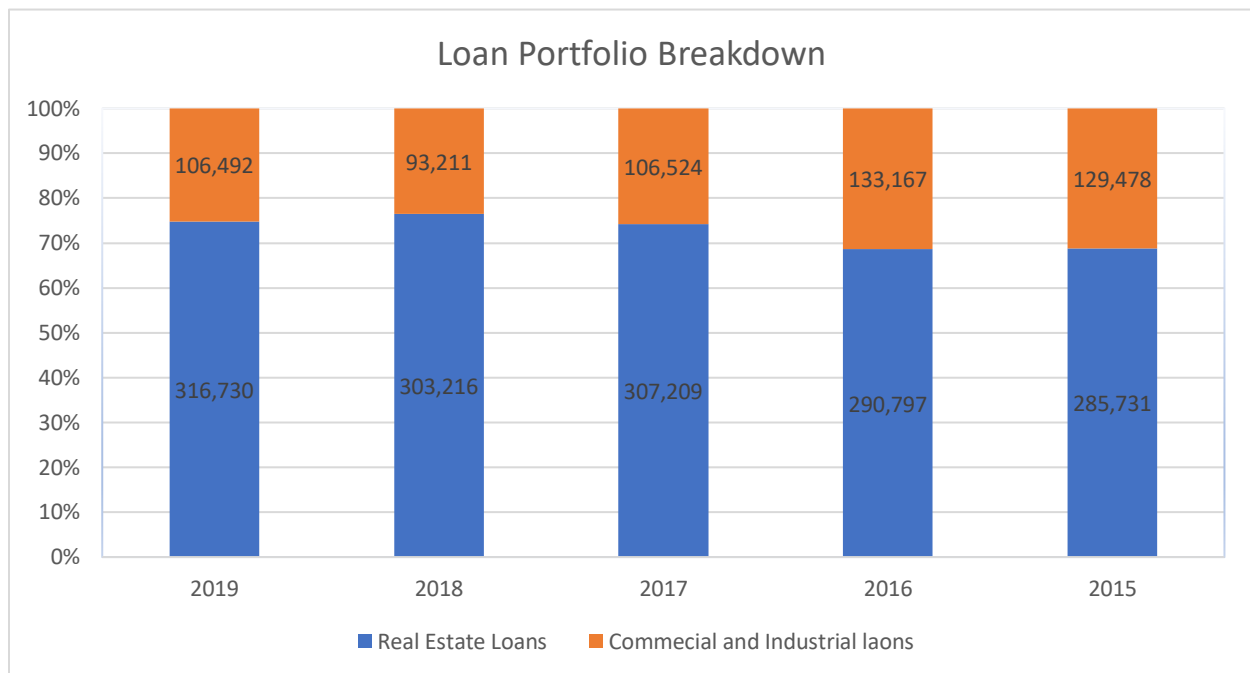
When comparing United Community Bank to its peer group, its net income attributable to the bank, which is also called the return on assets (ROA), for 2019 was 1.86% compared to the peers' average of 1.3% (\$100million to \$1billion). United Community Bank's ROA had declined in the years 2016 and 2018 but saw a return of 399.85% (year-over-year) in 2019. United

Community Bank's return on equity (ROE) for 2019 was 12.35% compared to the peer group of 10.46%. United Community Bank's ROA and ROE both grew in 2019, mainly due to their increase in net income. The net interest margin rose by \$4.03 million over the five-year period, which is an increase of 20.33%.



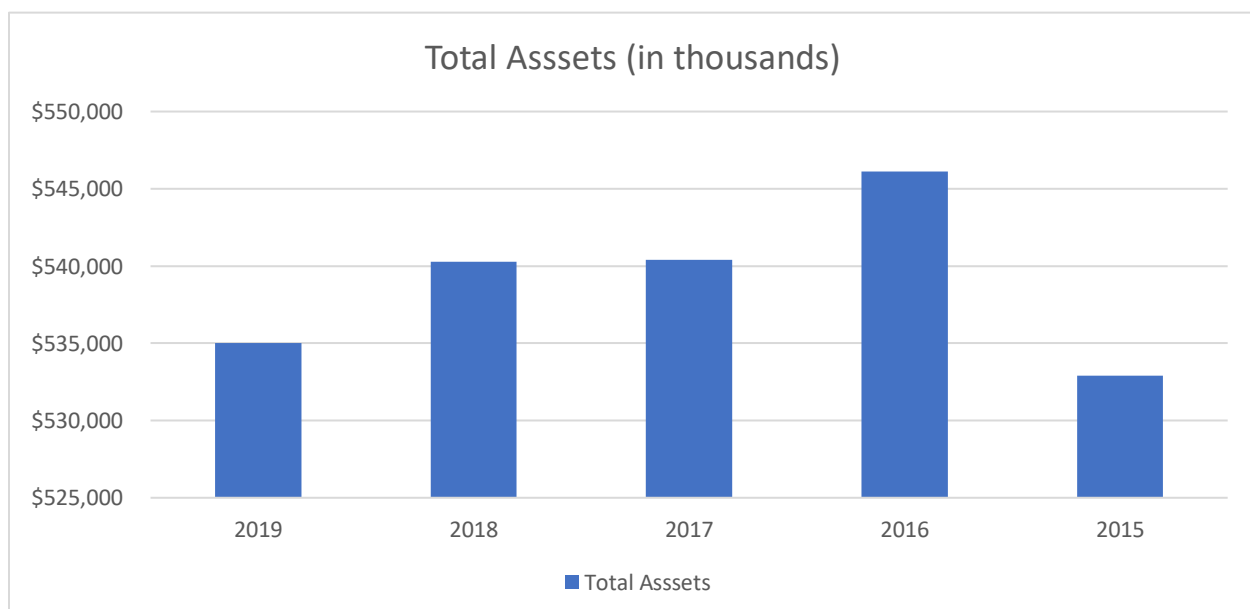
Loan Portfolio Composition

United Community Bank's loan portfolio in 2019 was \$413 million, which is a decrease from their balance in 2015 of \$414 million. The portfolio mainly consists of real estate loans (59.2% of total assets) and commercial and industrial loans (19.9%). Real estate loans have been their best-growing accounts in the loan portfolio as they have seen an increase of 10.85% in value since 2015. Although, United Community Bank does offer a small number of loans to individuals and farms, but both account for less than 1% of total assets. Farm loans were always low except in 2018 when they increased by \$366,000; however, they fell by \$369,000 the following year.



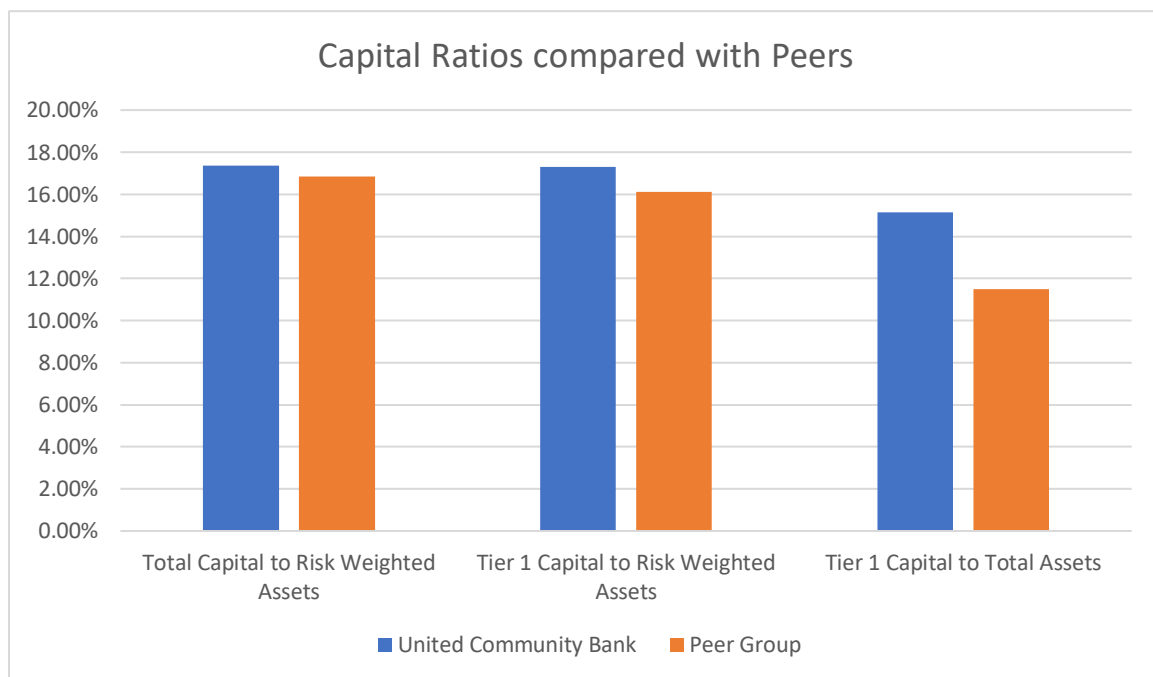
Asset Growth

United Community Bank has increased in total assets over the past five years. United Community Bank's total assets between 2015-2019 were ranging from \$532 million to \$546 million, peaking in 2016. Securities have decreased from \$33.7 million in 2015 to \$18 million in 2019, a change of -46.48%. However, United Community Bank did have an increase in cash and interest-bearing balances of \$19.3 million (42.16%) and \$16.1 million (44.64%), respectively. Loan loss allowance also increased during the five-year period by \$5 million (60.11%).



Capital Levels

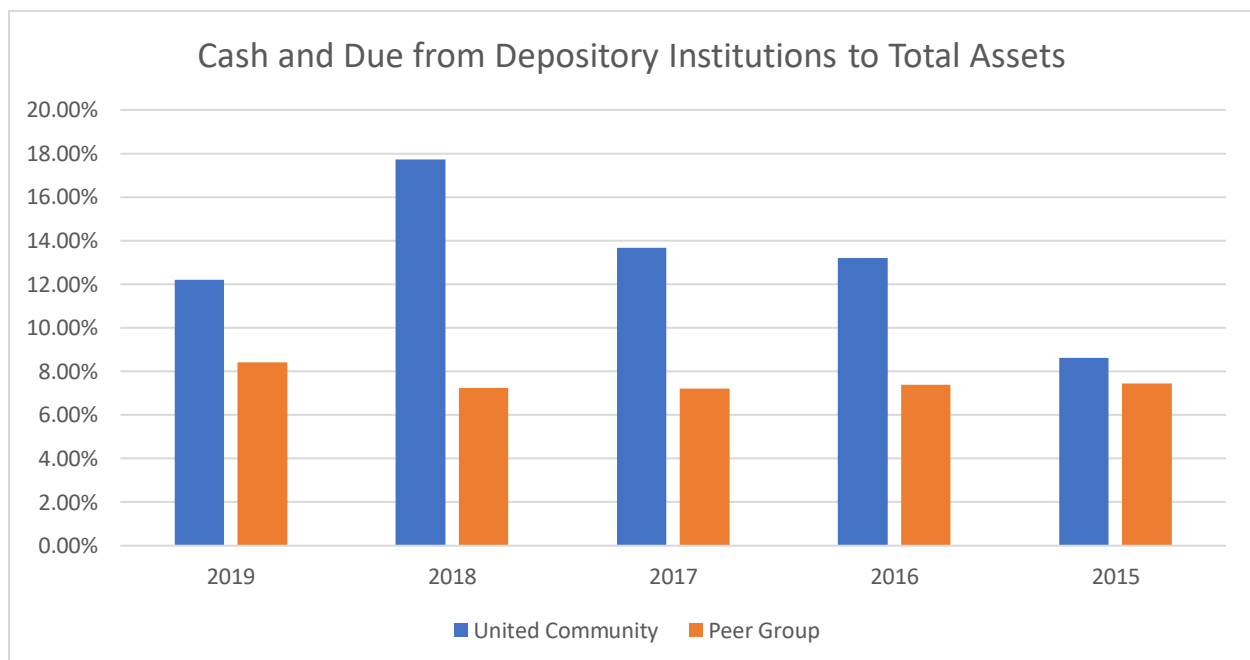
United Community Bank is well-capitalized. According to their capital ratios for 2019, the bank has a total capital to risk-weighted assets of 17.36% (10% required), tier 1 capital to risk-weighted assets of 17.31% (6% required), and tier 1 capital to total assets of 15.13% (5% required). United Community Bank has maintained a satisfactory level of capitalization over the five-year period. Furthermore, United Community Bank outperformed its peers as the average capitalization ratios was 16.85% for total capital to risk weighted assets, 16.10% for tier 1 capital to risk weight assets, and 11.49% for tier 1 capital to total assets.



Liquidity

Liquidity risk is a major issue that banks must plan around. Banks need to be liquid enough to be able to cover any withdrawals as to not damage customer trust with the bank. Several ratios can help identify a bank's liquidity risk. These include the cash and due from

depository institutions to total assets and total loans to total deposits. When comparing United Community Bank to its peer group it outperforms its competition in both measures. In 2019, United Community Bank had a cash and due from depository institutions to total assets of 12.2% compared to the peer group of only 8.42%. United Community Bank also had a 94.66% of total loans to total deposits ratio against the peer average of 81.31%. Overall, United Community Bank outperformed the peer group in both ratios throughout the five years as shown below.



Part 2: Bank Secrecy Act and Anti-Money Laundering Act (BSA/AML) Compliance Assessment

There are many processes and methods that come together for the bank to conduct an overall risk assessment concerning the Bank Secrecy Act and the Anti-Money Laundering Act. This is a demanding task that requires training, detail, and focus on the employees' part, such as proper and detailed documentation, and more. These processes can be costly to an institution as approximately 0.85% of non-interest expenses are accrued due to BSA/AML compliance efforts.

The cost of an independent audit can reach just under \$10,000. Four full-time employees are dedicated to focusing on compliance at United Community Bank. These employees need to be trained. It may cost anywhere from \$170 to \$200 just for a one-day training for an employee. There are also online, third-party training programs for employees that cover broad regulatory compliance. Some are offered by the Louisiana Bankers Association. These pieces of trainings, while highly beneficial to compliance, all bring additional costs to the institution. Currently, BSA/AML compliance reviews make up 24.2% of the total compliance and external audit expenses. Management believes that their current processes are about as cost-efficient as they can be. Still, they may look into internal staff completing further reviews and tests to look into where expenses may be decreased.

When it comes to compliance and meeting the Bank Secrecy Act requirements, the first step is proper education and training of employees. Front line staff is often the first defense; therefore, they must be trained on how to detect red flags and what to do when a red flag is raised. For example, tellers do not have to accept suspected fraudulent checks. However, if ill-gotten funds are deposited, they can only be held for a certain period, which necessitates proper time management. Any concerns of the employees need to be recorded and taken care of in a

timely manner. Although the human factor is of significant importance, the importance of automation cannot be disregarded. These systems help to identify patterns; however, only if proper documentation was provided accurately. One of the critical documents that are needed are reconciliations as they allow review of the bank's risk assessment.

Currently, United Community Bank requires no changes to their structure to complete and satisfy compliance requirements. Whenever regulatory visits and reviews are made, a few tips in best practices are typically offered. However, these tips are given to every bank regardless of satisfactory standing. These informal but beneficial tips may include the request of new specific documents, for example.

There are a few challenges that are being faced under the current compliance framework. The main challenge are the concerns of the sale of drugs, especially marijuana. Before a banking institution can provide service to a potential customer, they need to know the business behind each account member. However, the problem consists of contrary laws both at the state level and federal level. Which regulations should the institution follow, the state regulations, or the federal regulations? The question is difficult because the bank is state-chartered, but it is also federally insured by the Federal Deposit Insurance Corporation. Until the regulators specify which regulation is appropriate, the safest route is to follow the compliance regulations of the stricter enforcements.

Another challenge caused the BSA/AML act is the conflict of interest between the banking institution and the consumer base. For example, the banking institution will always be required to file a cash transaction report on any heavy cash-based customer, which can cause delays and frustration. However, the banking institution is not allowed to avoid filing the report even if the deposit is of regular routine for the customer. These types of issues are quite

problematic for local banking institutions as their primary selling point is the importance of the local customer. Community banks often know their customer's financing routines, which allows for easier detection of errors, fraud, and other unusual activity. However, this beneficial knowledge cannot always be taken into consideration due to regulatory requirements. Although banks want to protect their customers from the dangers of fraud, the BSA/AML act ultimately add another cost to the institution.

Part 3: Technology, Innovation, & Collaboration

Since the passing of the Bank Secrecy Act and the Anti Money Laundering Act, numerous programs and softwares have been developed to help with compliance. However, United Community Bank has not been actively searching for new technology to meet BSA/AML requirements as they already have existing programs and software in place to help them.

United Community Bank currently uses a program called Financial Crime Risk Management. This program is run by its core system called Fiserv. This program allows for real-time detection of fraud and reduces false positives. This allows for regulatory and operational efficiency while giving a holistic view across all the potential financial crimes, locations, and channels.

The Check 21 Act also allows the bank to reduce risk on the customer side as it reduces the number of people who physically handle the checks by creating a digital copy of the check that is sent to the bank. These programs have assisted United Community Bank in meeting BSA/AML requirements by helping to analyze potential crime risk and helping them respond to that risk efficiently. One area where United Community Bank would like to see the Fiserv's program improve is the ability to extract data from the program in a way that is easier for the examiners to edit the data and make comparisons. The program currently lacks the ability to sort data and pull it out of the system in an efficient manner.

Although FinCEN and the federal banking agencies are allowing banks to share resources on BSA/AML to help reduce regulatory costs on the banking industry, it is not effective. United Community Bank is not actively collaborating with any other banks at the moment. They have a network with other community banks locally to share information about their compliance efforts,

but they do not share information with any large banks except for fraud. They do not feel that sharing information with other banks, especially large national banks, would be beneficial to them, and this highlights the issue with FinCEN 3-14(b). Small community banks do not feel it is in their best interest to share helpful information to other banks when they do not feel as though the larger national banks will be as forthcoming with them about their issues and compliance efforts. United Community Bank will not be looking into putting anything into 3-14(b) unless something changes that forces bigger banks to also participate. FinCEN 3-14(b) was a good theory for banks to help each other, but without the trust between big banks and small banks or forced compliance from everyone, this will not be participated in by smaller community banks.

United Community Bank has had very few interactions with local or state law enforcement regarding BSA related interactions. United Community Bank does give local law enforcement access to their Suspicious Activity Reports (SARS), but typically law enforcement does not request or use these reports. However, local law enforcement cares about fraud and theft cases, but they are generally rare. United Community Bank handles many of these issues through frontline training for their employees and keeping long term data on all their repeat customers.

United Community Bank's interactions with FinCEN and the regulators have been good. However, they do think it is necessary for the regulators to have a little more training as some of the regulators struggle after significant changes in the laws for BSA/AML occur. It may prove beneficial for the regulators to have more defined guidelines on new regulations upon release rather than figuring out a workable system after-the-fact. The process that is in place now lengthens the compliance efforts and increases the cost to the bank. United Community Bank also thinks regulators could be more helpful in explaining the areas in which they can improve their compliance efforts. This would help United Community Bank, not just in their compliance

efforts, but also it would help shorten the time it takes regulators to approve a set guideline for the banks to follow.

United Community Bank does not currently have any plans to incorporate any innovative technologies in the BSA compliance efforts in the short term. They do, however, plan to take advantage of any such technologies available in their more long-term approach. This is mainly because they are meeting all their compliance requirements at this moment, but as they grow and their risk increases, they believe new technology and innovations will be helpful to them maintaining their compliance efforts. Their senior management is very compliance orientated and believe technology and frontline training are the best way to help keep up their efforts. Senior management believes that technology can go only so far in helping them flag these unusual cash transactions that these regulations are looking for and that the compliance effort starts with proper employee training and knowing the customers you are serving. The United Community Bank's senior management has a classroom at their headquarters just for the purpose of training and meeting with their employees. They believe that the training has helped just as much as the technology has.

Part 4: Policy Recommendation & The Future of BSA/AML

The Financial Crimes Enforcement Network's mission is to safeguard our financial system from illicit use, combat money laundering, and promote national security through the collection, analysis, and dissemination of financial intelligence (Mission). To fulfill its mission statement, FinCEN conducts three important processes:

- Issues and interprets regulations authorized by statute
- Supports and enforces compliance with those regulations
- Conducts analysis to support policymakers; law enforcement, regulatory, and intelligence agencies; FIUs; and the financial industry

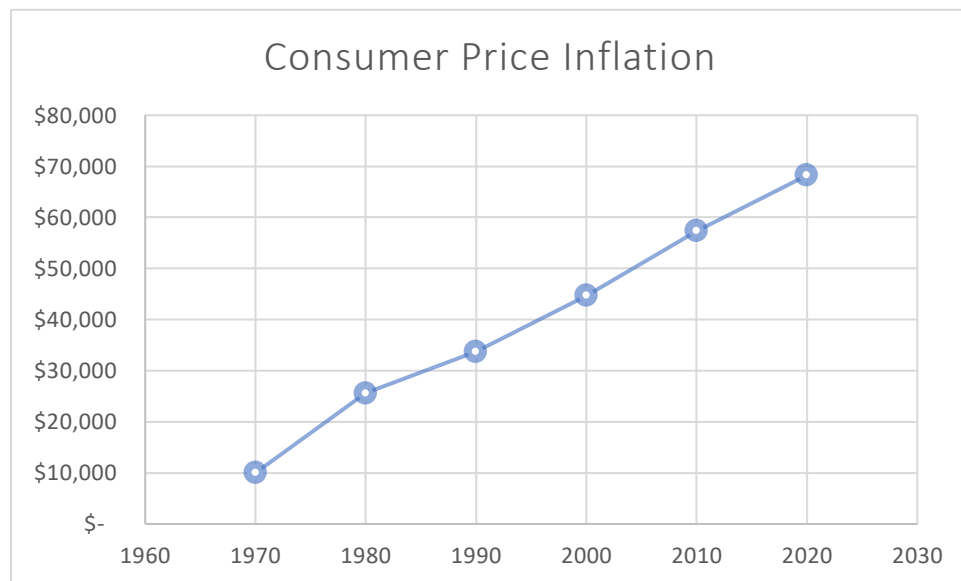
As FinCEN continues to issue and interpret new regulations, United Community Bank has a few requests and recommendations to improve regulatory compliance.

United Community Bank would like to receive preliminary guidance before new statutes are enacted into law. Preliminary guidance could significantly reduce costs for both the financial institutions and the federal regulators as it eliminates trial and error costs of repeated inspections.

An alternative to preliminary guidance is an extended testing period for new regulations alongside regulator insight and explanations of essential requirements of the act.

United Community Bank's key recommendation to modernize the Bank Secrecy Act is to account for inflation in currency transaction reports. Currently, currency transaction reports must be filed if cash transactions over \$10,000 are conducted by, or on behalf of, one person, as well as multiple currency transactions that aggregate to be over \$10,000 in a single day (CTR Reference Guide).

The Bank Secrecy Act initiated the currency transaction report in the 1970s, which still maintains the fixed \$10,000 cash transaction threshold for automatic filing. According to the CPI Inflation Calculator, if someone had purchased a \$10,000 item in the 1970s, the same item would cost \$68,246.30 in 2020, which represents an inflation increase of 582% over the fifty-year period.



With the passage of time, the Bank Secrecy Act needs to update the \$10,000 cash transaction trigger for automatic filing. The transaction threshold should either be increased in a fixed amount or through the inclusion of an inflation rate. For the regulators to retain more control over the cash transaction threshold, they can use the fixed increase. For a continuous adjustment to the cash transaction threshold, the addition of an inflation rate would be more beneficial.

United Community Bank recommends that the cash transaction trigger should be increased to at least \$25,000 to induce a significant savings of time and resources. If the regulators adjust the Bank Secrecy Act's currency transaction report requirement, it will help

reduce the burden of BSA/AML reporting for financial institutions, regulators, and cash intensive businesses.

Lastly, FinCEN and law enforcement should be more transparent and share statistical data about the effectiveness of suspicious activity reports and currency transaction reports that could benefit the local community banks. Having an open network to share information about peculiar transactions across financial institutions and government agencies could prevent financial crimes.

Conclusion

In conclusion, United Community Bank is a great financial institution that focuses on providing the local people with a personalized service. The financial analysis reveals that United Community Bank's earnings performance has soared 389.24% over the five-year period. While their loan portfolio primarily consists of real estate (59.2%) and commercial and industrial loans (19.9%), United Community Bank's asset growth has maintained a slow upwards climb from \$532 million assets to \$546 million assets. All the while, United Community Bank upheld the necessary capital levels to be considered well-capitalized. Meanwhile, United Community Bank's compliance with the BSA/AML act reveals the substantial costs that are required to fulfill regulatory standards and that improvement is necessary from both the banks and the regulators. Both sides of the banking industry need technological innovations to help improve upon data collection and collaboration to better handle the BSA/AML act. With that, United Community Bank's final policy recommendation to help improve the future of the BSA/AML act is to account for inflation for these aged regulations. Overall, maintaining open communication between the regulators and the local community banks will help ensure that small communities may thrive.

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