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Banking & Financial Services

Cryptocurrencies and What They Mean for Banking

By **KRIS ST. MARTIN**

Technology has added efficiency and modern conveniences to your customers' daily lives. Among these conveniences, computer experts have managed to apply digital traits to new, online currencies that are commonly called cryptocurrencies.

Cryptocurrencies are digital currencies that use encryption techniques to regulate the generation of units of currency and verify the transfer of funds. This digital money operates separately from a bank and can be used similar to cash around the world. The digital nature of these currencies provides some benefits that appeal to consumers thus increasing their popularity.

Bitcoin, the most popular cryptocurrency, was declared legal tender in Japan in 2017. Online businesses like Microsoft, Overstock and PayPal also accept the currency. Libra, one of the newest digital currencies and infrastructures, addresses two major criticisms of cryptocurrencies in two ways: (1) it will be backed by a reserve of assets and (2) founding members include large payment companies, technology firms, marketplaces and recognizable global brands (eBay, Uber, Vodafone), likely ensuring a wider acceptance as a payment instrument than other cryptocurrencies. Overlaid with Facebook's broad reach (about 2.4 billion users), Libra should benefit from a wider audience and could eventually disrupt corporate payments.

After being trapped in a bitter bear market throughout 2018, bitcoin seems to be back, and with the introduction of Libra to the Facebook audience it seems likely that some of your customers will be caught up in the excitement and potentially lucrative nature of

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cryptocurrencies. What better time for a refresher on how they work, as well as their positives, negatives and risks?

How Do Cryptocurrencies Work?

While it may seem confusing on the surface the way cryptocurrencies function is actually quite simple. Like most currencies used around the world, cryptocurrencies store value, have specific exchange rates and are limited in supply. However, most are decentralized and work without administrators; instead they rely on encryption technology and verification to make transfers. This means there is no central authority that manages the creation and use of cryptocurrency.

In place of a central authority, most cryptocurrencies implement a network that allows users to make transactions directly between each other. These networks use a shared system of private keys and public ledgers to authenticate new transactions and create an encrypted log of past transactions. Bitcoin, the first cryptocurrency to implement this form of authentication, encourages users to participate in the system by rewarding them with additional bitcoins. In fact, this is the only way that new bitcoins circulate.

To use cryptocurrencies, consumers and businesses must first acquire a cryptocurrency wallet account. These accounts work like a bank but are designed specifically for individuals who want to purchase or accept cryptocurrency. Most cryptocurrency coins have an official wallet or recommended third-party wallets. It's important to conduct thorough research before choosing a service.

After you have acquired a wallet, you can purchase cryptocurrencies on open exchanges and use them for a variety of transactions. They can be converted to cash at a later date.

Before businesses adopt cryptocurrencies, they should consider the benefits and drawbacks and how they may impact operations.

Benefits of Cryptocurrencies

- **Little or no processing fees** — Unlike credit cards and other traditional forms of payment, cryptocurrencies often have no processing fees. This is because transactions are facilitated through the cryptocurrency's public network on what is known as a blockchain. Transactions are recorded on the blockchain chronologically, and users can create, verify and enforce transactions without an intermediary or central authority.
- **High transaction speed** — Credit and debit card payments often take two to three days to process and clear. With cryptocurrencies, transactions happen in real time and take about 10 minutes or less. As an added bonus, cryptocurrency transactions are final, which means consumers can't dispute a charge and negate a sale.
- **Increased payment options** — The more payment options you can provide as a business, the better. As such, cryptocurrency has the potential to attract a wider customer base.

Drawbacks of Cryptocurrencies

- **Price volatility** — The value of bitcoins and other cryptocurrencies can change drastically over a small

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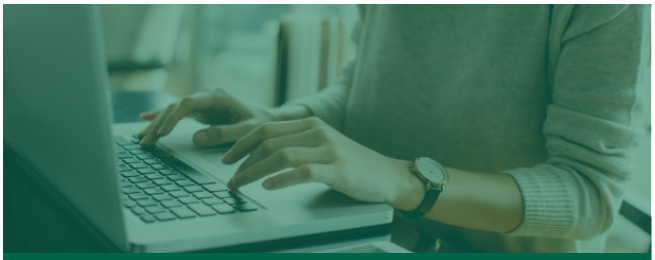

Upcoming Webinars & Events

Webinars are "no fee" and open to all interested parties. Upcoming webinars and events can be found **here**. Please note - the "register" links often provides the recorded versions if the date of the live version has passed.

CBIZ Employee Benefits On-Demand Webinars, available 24/7, can be found **here**.

Featured webinar: Ensuring Your Business is Prepared for the Next Disaster [on demand]

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period of time. Bitcoin reached a value of $17,000 in January 2018 before falling to $7,000 less than a month later.

- **Anonymity** — While the details of cryptocurrency users and transactions are often held in a public ledger, names and locations are encrypted. This can be an issue when complying with regulations on customer identification or fraud protection.
- **Cybersecurity** — Cryptocurrencies exist digitally, and the proof of ownership is often limited to the private keys used to authenticate transactions. This makes cryptocurrencies a prime target for hackers, especially because many businesses aren't aware of how to protect this new form of currency. (Ironically, cyber criminals make their ransomware demands in Bitcoins.)
- **Intrinsic value** – Historically, money must be both a medium of exchange and a reasonably store of value. Although a seemingly terrific medium of exchange, it has been unclear why cryptocurrencies would be considered a reasonable store of value. They are neither backed by a tangible (gold) object or by the full faith and credit of a government. (The new entry, Libra, is backed by a reserve of assets designed to give it intrinsic value.)

One of the key questions worldwide regarding financial transactions accomplished in cryptocurrencies is the issue of taxation. Governments will undoubtedly seek to play a larger role in the cryptocurrency scheme of things, particularly with respect to security and tax compliance. Coming guidance from the IRS will address longstanding questions about the tax treatment and, just recently, President Trump weighed in as "not a fan" with his July 11 tweet. More on this topic to come.

Should Banks Be Concerned about Customers Accepting Cryptocurrencies?

While global companies like Amazon and Microsoft accept cryptocurrency that does not necessarily mean it is right at this time for many small businesses. Before using cryptocurrency, your bank's business customers should conduct adequate research to understand how it may impact the company. As a financial advisor, bankers should have an understanding of cryptocurrency and be prepared to have thoughtful conversations with their customers. In addition, a qualified insurance broker should be consulted to determine how using cryptocurrency may open the business up to new risks. We will address the risk perspective more directly in a future article.

Your Team – We Are Your Risk Management Experts

Managing risk is a key factor in meeting compliance requirements, as well as safeguarding you and your customers' assets. CBIZ risk consultants in our banking and financial services group have the knowledge and experience to provide comprehensive insurance and risk solutions designed to safeguard your institution. Don't hesitate to reach out to Kris St. Martin, Director of CBIZ Financial Institution Services, at 763.549.2267 or kstmartin@cbiz.com for more information. We encourage you to check out our latest blog post on the **Top Cyber Threats for 2019** or register for our upcoming webinar: **Ensuring Your Business Is Prepared for the Next Disaster**.

Making the Case for Diversity on Bank Boards

By **TOM CARIGNAN**

Do bank boards that are ethnically, gender and age diverse offer an advantage both in recruitment and in strategy development? Asset managers BlackRock and State Street Global Advisors certainly think so; both routinely vote against nomination of new directors on boards without female representation. Their point: Diverse boards will be less prone to groupthink, more attuned to the needs of today's consumers and employees, more alert to opportunities for growth, and less likely to overlook threats to the business.

Companies with greater gender diversity in their leadership outperform their less diverse competitors, have higher returns on capital, and are credited with better employee engagement and retention. Even so, corporate America is still grappling with how to make U.S. companies and workplaces more reflective of the diverse makeup of our country, but banking appears to be doing substantially better than most other industries.

Banks and credit unions recognize the advantages of seeking out directors with skill sets that will significantly contribute to oversight and management of the organization. This isn't new. What *is* new is the acknowledgment that traditional qualifications for directors such as financial and operational skills and industry experience are fading as the sole prerequisites

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for a seat in the boardroom. And while board diversity matters, concentrating on only one form of diversity may not meet the need.

To build an understanding of and response to the increasingly complex issues and opportunities facing financial institutions today, the very concept of diversity needs a makeover. No longer referencing solely race and gender, diversity on boards should also include experts in new technology, cybersecurity, marketing, innovation and international business, as well as those with recruiting credentials who can help find talent needed across the organization.

Take Advantage of Diversity

Diversity will not have much impact on boards where members' perspectives are not regularly elicited or valued. Boards with an egalitarian culture will be in better position to take full advantage of the contrasting experiences and insights that diversity delivers. In contrast to hierarchical boards, more egalitarian boards encourage information to be shared openly, with little "back channeling" or meeting outside of the formal meeting to raise concerns. They are more likely to accept and integrate differences of opinion.

Several reasons are cited to explain why companies with more diverse boards seem to perform better. One is that diverse boards often better mirror customer and client bases. Eastern Bank's success story is a case in point.

Based in Boston, Eastern Bank is America's oldest and largest mutual bank. Since 2003 Eastern has placed great importance on diversity and inclusion among its directors, trustees and shareholders. They progressed from an overall board composed of 92% white males to, as of 2018, a board with 50% of the 140 members being people of color, women or individuals from the LGBTQ community. In addition, their board members reflect a vast array of professional backgrounds, skills and expertise.

Eastern's board diversity didn't just materialize on its own. It evolved thanks to sustained commitment from senior leadership, in particular the bank's current chair and CEO, Robert "Bob" Rivers. He believes there is a direct connection between Eastern's unique board diversity and its rapid growth. Specifically, it has helped Eastern improve its strategic decision-making, recruiting, innovation and connection with the community.

Be Aware of Potential Obstacles

Long tenure and the absence of a mandatory retirement age can work against the strategy of diversifying boards. Ideally, mandatory retirement guidelines or term limits will be in place, but industry pundits agree that most financial institutions should not rely on retirement to provide the opportunity to invite diversity into the boardroom.

Broadening the range of professional backgrounds considered for board member positions is easier to achieve when boards avoid filling open seats with people

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already in their personal and professional networks. If board vacancies are filled with a "who do we know" approach, the opportunity for diversity can be waylaid if board members only know people like them.

Tokenism is often an unintended obstacle that can dilute the overall initiative by solely focusing on percentages of diversity on the board without further consideration of the specific skills the new diverse members can bring to the board's decision-making responsibilities.

In particular, the lack of women in the C-suite exacerbates this effect. Women remain severely underrepresented in banks at this level, with women CEOs representing just 4% of the industry, according to an analysis by S&P Global. This spreads to women in the banking boardroom, as well, because when the search is underway for a new board member with banking expertise, it frequently begins with those CEOs and others at the highest level. Without more women in those positions, the selection pool is significantly limited.

Several Ways to Meet the Challenges

As an executive search consultant who works on multiple board of director placements each year, I am often told by professionals, "I want to serve on a corporate board." I often reply that the only qualification to be on a board is to be on a board, which really means there is no single way to approach board service.

One of the first pieces of advice I would offer is to be an expert at what you do. When our firm is retained to help identify potential directors we are most often given a list of must haves and wants that generally target executives who have successfully operated and led their organization or division in a large corporate environment. Today, demand is particularly high for those who have led in high-growth organizations and industries – executives who have proven they can take companies to new heights of success.

Secondly, be networked in your industry and market verticals. Most of our outreach is done behind the scenes away from the reaches of LinkedIn and other professional networking sites. We make calls and ask for referrals. Notoriety and connections in your area of expertise will greatly increase the probability your name surfaces. Also, network with executive recruiters who work on board searches; offer to be one of their referral

sources. Giving recruiters access to your network highlights your value as well.

A last piece of advice – explore one of the many organizations providing board preparedness programs and executive education. Organizations like the National Association of Corporate Directors (NACD) have a host of resources that can point you in the right direction and help prepare you for future board service.

Your Team

The author, Tom Carignan, has deep roots in the banking industry, having served a variety of roles with Commerce Bank and UMB Bank prior to joining EFL Associates, a leader in recruiting C-suite executives for financial services companies. For additional conversation on this article and related topics or for assistance with talent and compensation initiatives, don't hesitate to reach out to Tom directly at 816.945.5413 or tcarignan@eflassociates.com.

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Overruled: Rejection of Proposed Changes Indicates New Credit Loss Standard Will Be Implemented on Schedule

The Financial Accounting Standard Board (FASB) dealt a blow to the financial services industry during a recent board meeting. On April 3, the FASB rejected a proposal from a group of regional banks related to changes to the credit loss impairment standard.

Financial services groups and other lenders are gearing up for significant changes to accounting for financial instruments and credit losses. The FASB's Accounting Standards Update (ASU) 2016-13, *Financial Instruments – Credit Losses (Topic 326)* is effective for fiscal years beginning after Dec. 15, 2019 (generally calendar year 2020 for public business entities) and Dec. 15, 2020 (generally calendar year 2021) for private entities.

FASB's credit loss impairment changes could have a dramatic impact on financial services organizations because it is likely that these organizations will be recognizing credit losses earlier than they do under current U.S. generally accepted accounting principles (U.S. GAAP). Credit loss impairment in existing U.S. GAAP follows an "incurred loss" impairment model where entities recognize impairment losses when the credit losses are incurred or when a triggering event indicates it is probable a financial instrument will have credit impairment. Changes to the credit loss impairment model in ASU 2016-13 will require entities to record a lifetime expected loss as an allowance, known as the Current Expected Credit Loss (CECL) reserve, when a financial instrument is acquired.

Financial Services Groups Push Back

A group of regional banks submitted a comment letter to the FASB in November 2018 about the impact the measurement of credit loss for financial instruments would have on their sector. The group proposed an alternative to the CECL model where a reporting entity could recognize the credit loss for impaired and non-impaired financial assets differently. For non-impaired financial assets, the reporting entity would record loss expectations within the first year to Provisions for Losses in the income statement. Loss expectations beyond the first year would be recorded to Accumulated Other Comprehensive Income (AOCI). For impaired financial assets, lifetime expected credit losses would be recognized entirely in earnings.

In its letter, the group argued that its proposed changes would align with the matching principle definition of an expense in FASB Concepts Statement No. 6 while still

providing financial statement users with additional insight into a financial instrument's lifetime risk. The letter also suggested that the new credit loss standard creates challenges for forecasting the changes in economic conditions that could affect credit loss impairment and may result in institutions adjusting their estimates to credit loss impairment at the onset of an economic downturn, potentially "exacerbating" the effect of that downturn on financial instruments.

A follow-up letter on the matter was sent in January 2019, where the regional bank group reiterated its points and requested a delay in the roll-out of the new credit loss standard.

Takeaways from the FASB's Response

The FASB did more than reject an accounting change proposal in its April 3 meeting. When it ruled not to add the regional banks' accounting change to its technical agenda, the FASB also indicated that the credit loss impairment standard is still on track to roll out as scheduled. Financial institutions and other entities have been asking for a delay in the implementation of the standard.

Moving Forward

Entities that hold or acquire a significant number of financial instruments need to be preparing now for the potential impact of the change to the credit loss impairment model. It does not appear likely that a longer implementation window will be offered. For assistance in assessing how your organization will be affected by the accounting change, please contact us.