the sub S bank report

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From the President

Dear Sub S Bankers and Friends,

We appreciate your continued support of the Association which has enabled us to do the work of maintaining the benefits of the Subchapter S election for community banks. The expiration of Section 199A has become an enormous priority for all Sub S Banks as the window on the Qualified Business Income comes closer to closing – December 31, 2025.

As you will see in this Report, Senator Daines of Montana has introduced a bill to make 199A permanent and to extend certain other expiring provisions of the TCJA of 2017. It is imperative that all Sub S Banks talk to their elected Senators and Congressman about the importance of making 199A a permanent part of the IRC.

Since the original legislation was signed permitting banks to make an S election in 1997 and the coincident formation of the Association the following year, we have had a generous and enthusiastic group of Advisory Board members who have been principal shareholders and Senior leaders of prominent Sub S Banks across the country. A number of them are no longer with us and we salute them for their vision and wisdom in supporting Subchapter S for Banks.

We thought it made sense to identify a new generation of such leaders now 25 years later and are pleased at the response we have received and welcome the following new members:

- Michael Wallace, Chairman of the Board of Freemont Bank, Fremont, CA,
- Russell Williamson, Chairman of Citizens National Bank and its holding company, Meridian Mississippi,
- Patrick Ware, Vice Chairman, Amarillo National Bank
- Ryan James, President/CEO of Surety Bank, DeLand, Fla.

Thank you very much for your willingness to join our Advisory Board!

We appreciate those of you who have continued to support our work financially and participated in other important ways such as testifying and appearing before US Treasury and the IRS regarding important regulations being drafted to implement 199A. We have kept our annual dues at a very

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moderate level for the nearly 30 years since the founding of the Association and many Sub S Banks benefit from our work including our Annual Conferences, the Sub S Bank Report and our Webinars. While our primary goal is to preserve and protect the value of the Sub S election for community banks, we are always sharing new ideas and strategies in support of community banks.

We encourage those of you who may not have joined the Association as supporting members, to consider doing so now as we move to the extremely important work of making 199A permanent.

While that is of utmost importance, I would like to refresh the discussion we had at our Annual Conference last October where we had a video conference with then Chairman of the Ways and Means Committee Kevin Brady who has been a real champion for Sub S banks and with whom we worked closely in 2017 to assure passage of the TCJA in a form that fairly benefited Sub S Banks as related to the corporate tax reduction of C Corps. Included in that discussion was Congressman Drew Ferguson and now Chairman Jason Smith's Senior Legislative Aide Kathryn Chakmak, Legislative Assistant & Tax Policy Advisor, Honorable Jason Smith, (R- Mo). In addition to making 199A permanent, there was significant discussion about the possibility of improving 199A to include investment management income from bank trust departments and related businesses as well as other features that were mostly eliminated through the rulemaking process. While there was clear interest on the part of the Congressional leadership present, the practical wisdom of the legislative process suggests that a simple one line change to 199A eliminating the December 31, 2025 expiration date would be the most important objective.

For those of you who do not know the history of the Association, it was just this kind of creative thought process and grassroots effort that resulted in the 1997 legislation amending the IRC to permit banks to make a Sub S election. I was fortunate to be representing some thoughtful bank investors in Texas – The George Hawn Family – who helped initiate that effort and allowed me to serve as their point person in Washington as we developed a small group of other bankers – such as Ross McKnight of Throckmorton, Texas and a few others around the country who had friends on the Hill with whom they could reach out. This kind of outreach is key if we are to keep community banking alive and well in this country.

Thanks to all of those who have participated, supported and otherwise encouraged thee efforts during the now almost 30 years! Please continue to engage!

Very truly yours,

Patrick J. Kennedy, Jr.
June 19, 2023, San Antonio, Texas.

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New Opportunities to Finance Investment in Green Energy by Tax-Exempts

By: Mel Schwarz, CPA, J.D and Paul Sirek, CPA; Eide Bailly LLP.

Overview

Legislation enacted in 2022 has finally made available to tax exempt entities the same tax incentives for investment in green energy enjoyed by taxable entities. This creates an opportunity to finance this investment at a lower cost to the tax-exempt entity and with greater profit potential to the banks that provide the necessary financing.

What Changed?

Before this year, tax-exempt entities could not directly share in the Federal tax incentives for investing in green energy. Although they were often interested in taking a leading role in reducing the environmental footprint, they could not utilize the incentives in the same way as taxable businesses. A tax exempt paid $100 for a solar panel that cost a business down the street significantly less after tax. Government entities, schools, and other tax-exempt entities were left out of the tax benefits for green energy investment.

The Inflation Reduction Act of 2022 (IRA) addresses this disparity beginning in 2023. Instead of a credit that could only be used to reduce Federal income tax, tax exempt entities can now use new section 6417 to elect "direct payment" of the same amount that a taxable entity would enjoy as an income tax credit.

Prior to this change, a tax-exempt entity could only access the credit by entering into a partnership with someone who could use the credit to reduce their tax or by leasing the green energy property. This necessitated sharing the benefit with a third-party investor and the tax shelter promoter, often at a cost substantially higher than the cost of borrowing the money directly.

How Does Direct Payment Work?

If direct payment is elected, the amount that would otherwise be treated as a tax credit is paid directly to the entity placing the green energy property in service. The election must be made by what would otherwise be the due date (including extensions) of the entity's tax return. The IRS is then required to pay the amount of the credit directly to the entity within 60 days in order to avoid paying interest itself. The IRS is expected to publish detailed rules later this year.

What Property is Eligible for Direct Payment?

Direct payment is available for a wide range of green energy expenditures. For example, property that generates electricity from an alternative energy source such as solar, wind, fuel cells, and waste to energy and the technology necessary to coordinate the electricity produced qualifies for direct payment. The refueling property necessary for the effective investment in a fleet of alternative fuel vehicles as well as investment in clean energy commercial vehicles should also qualify. A detailed list of eligible expenditures is included in IRS Notice 2020-50.

Benefits to the Bank

Local and regionally focused Subchapter S banks have traditionally been leaders in support of their communities. Serving as the financing partner for the environmental initiatives of the city, school system, local college, and charity hospital is squarely within that important role.

The direct payment feature also provides a backstop for the repayment of the loan. Generally, 30% of the cost of the property financed will be paid to the tax-exempt borrower within 6 months of the end of the year in which the property is placed in service, which will be a key factor in the debt servicing capabilities of the borrowers.

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Breaking Down Revenue Procedure 2022-19

By: Kevin F. Powers, CPA I Partner I Washington National Tax, Crowe LLP

In October 2022, the IRS issued Revenue Procedure 2022-19, providing taxpayer assistance procedures allowing S corporations and their shareholders to resolve frequently encountered issues without the need for a private letter ruling. The procedures outlined in the revenue procedure will reduce IRS and taxpayer burdens, facilitate increased taxpayer compliance, and reduce costs and delays for completing transactions involving S corporations and Qualified Subchapter S Subsidiaries ("QSubs").

This is the first significant procedural guidance for S corporations since the IRS published Revenue Procedure 2013-30 in August 2013. That revenue procedure primarily focuses on relief for late S corporation elections, Electing Small Business Trust elections, Qualified Subchapter S Trust elections, QSub elections, and late corporate classification elections. However, Revenue Procedure 2013-30 still does not provide relief for a variety of issues that S corporations and their shareholders may face, particularly related to inadvertent terminations of S elections.

Over the past few decades, taxpayers have requested, and the IRS has issued, hundreds of private letter rulings regarding inadvertent terminations of S elections. In many instances, the S corporations never actually engaged in any specific actions which violated the Code Section 1361 provisions, but rather had inconsistent language in their governing provisions conferring differing rights in distributions and liquidation proceeds to their shareholders, for example. Thus, the IRS recognized that in many instances these private letter rulings were ultimately unnecessary, and that taxpayers could likely resolve the underlying concerns without any intervention by the IRS.

In some ways, Rev. Proc. 2022-19 fills the gaps that were not otherwise covered by Rev. Proc. 2013-20, although there may still be instances in which neither revenue procedure will apply, and thus the only relief that may be available will be requesting a private letter ruling from the IRS. Taxpayers and their advisers will have to evaluate each situation, based upon the particular facts and circumstances, to determine which, if either, of the revenue procedures may apply, and then which particular action(s) must be taken to cure the problem.

More specifically, Rev. Proc. 2022-19 covers six areas that can be resolved without a private letter ruling:

1. One class of stock requirement and governing provisions, including "principal purpose" conditions. The IRS states that it will not treat an S corporation as violating the one class of stock requirement, so long as an agreement or arrangement that is not a governing provision does not have a principal purpose to circumvent the one class of stock requirement. Examples of these non-governing provisions may include buy-sell agreements among shareholders; employment agreements between the S corporation and shareholder-employees that may ultimately be determined to provide excessive compensation to the shareholder-employee; or perhaps even a lease agreement between an S corporation-lessee and a shareholder-lessor providing for rental payments which may ultimately be determined to be more than market rates. Pursuant to the revenue procedure, taxpayers do not need to seek relief from the IRS in these instances, assuming there is no principal purpose to circumvent the one class of stock requirement.

2. Disproportionate distributions. A disproportionate distribution is defined as any distribution (including an actual distribution, a constructive distribution, or a deemed distribution) of property with respect to shares of stock that differs in timing or amount from the distribution with respect to any other shares of stock. The procedures, therefore, provide that a corporation is not treated as having more than one class of stock so long as the governing provisions provide for identical distribution and liquidation rights. In other words, it does not technically matter what distributions were made to the S corporation's shareholders, but rather what distributions were allowed to be made pursuant to the governing provisions of the S corporation. This may occur, for example, where a state law LLC makes a check-the-box election to convert from a partnership to an S corporation, but never rescinds or appropriately updates its original partnership/operating agreement.

3. Certain inadvertent errors or omissions on Form 2553, *Election by a Small Business Corporation, or Form 8869, Qualified Subchapter S Subsidiary Election*. The revenue procedure provides that an S election that fails to include the consent of a shareholder may be corrected under Treas. Reg. §1.1362-6(b)(3)(iii), Rev. Proc, 2013-30, or Rev. Proc. 2004-35. A Form 2553

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that contains an inadvertent error regarding a permitted year may be corrected under Rev. Proc. 2013-30. A Form 2553 or Form 8869 that is missing the signature of an authorized officer of the S corporation that affects the validity of the S election or QSub election may be corrected under Rev. Proc. 2013-30. Other errors may be corrected by explaining in writing the errors or omissions and the necessary corrections and submitting the explanation to the IRS. For those errors or omissions that are unable to be corrected using any of the other procedures listed above, the taxpayer may seek relief by requesting a private letter ruling from the IRS. For example, the relief provisions of Rev. Proc. 2013-30 are generally only available if no more than 3 years and 75 days have elapsed since the intended effective date of the applicable election. Thus, if this 3-year-and-75-day window has passed, the taxpayer may still be required to submit a private letter ruling request to the IRS – dependent upon the facts and circumstance.

4. Missing administrative acceptance letters for an S election or QSub election. Generally, within 90 days after the IRS receives a corporation's Form 2553, the IRS mails a CP261 Notice as an acknowledgment to the corporation that the IRS has accepted the corporation's filing. For QSub elections filed on Form 8869, the IRS mails a CP279 Notice to the filer and a CP279A Notice to the subsidiary, generally within 60 days after the IRS accepts the QSub election. A lack of written acknowledgement that the IRS has accepted the corporation's S election or its subsidiary's QSub election (for example, because it was lost or never received) creates uncertainty for some taxpayers about the validity of the election. Specifically, this issue may arise upon due diligence by a potential buyer of the S corporation's or QSub's stock, as the validity of the S election and/or QSub election may be relevant to the resulting tax consequences. A replacement acceptance letter may be requested by contacting the IRS Business and Specialty Tax Line at 1-800-829-4933 (or practitioners can use the IRS Practitioner Priority Service at 1-866-860-4259). The IRS states that it will not issue a private letter ruling regarding a missing administrative acceptance letter, as the validity of either the S election or QSub election is not directly dependent upon the receipt of an IRS acknowledgement.

5. Federal income tax return filings inconsistent with an S election or a QSub election. While perhaps not all that common, there are instances where a corporation may file a federal income tax return that is inconsistent with its status as an S corporation or a QSub. For example, a state law LLC that converts to an S corporation may have inadvertently filed a Form 1065, U.S. Return of Partnership Income. The revenue procedure provides that because a corporation is not treated as having terminated its S election or QSub election merely due to the filing of one or more federal income tax returns inconsistent with its elections, the corporation's distributions and other transactions will be treated consistent with its status as an S corporation or a QSub. However, the corporation, and its shareholders, may have to file corrected or amended tax returns, for open taxable years only, to properly reflect the corporation's status as either an S corporation or QSub.

6. Potential retroactive corrections of non-identical governing provisions. A "non-identical governing provision" is defined as a governing provision, that on its own or as part of another governing provision, results in the S corporation having more than one class of stock. The retroactive corrective relief procedure under Rev. Proc. 2022-19 would apply to limited liability companies, for example, that have failed to update their operating agreements before filing an S election, although it is questionable as to whether the procedure can be interpreted to apply to operating agreements that contain incompatible partnership tax provisions. The revenue procedure provides that an S corporation and each "applicable shareholder" (see below for the definition of this term) may retroactively preserve S elections that were inadvertently invalidated or terminated due solely to the adoption of one or more non-identical governing provisions if the entity:

i. Has or had one or more non-identical governing provisions;

ii. Has not made, or has not been deemed to have made, a disproportionate distribution to an applicable shareholder;

iii. Timely filed a Form 1120-S, U.S. Income Tax Return for an S Corporation, for each tax year beginning with the year in which the first non-identical governing provision was adopted and through the tax year immediately preceding the year in which it requested relief; and

iv. Before any non-identical governing provision is discovered by the IRS, the entity and its shareholders complete the corrective relief statements described in the revenue procedure.

For this purpose, an "applicable shareholder" means a current or former shareholder of a corporation who owns or owned stock of the corporation at any time during the period: (a) beginning on the date of which the non-identical governing provi-

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sion was adopted (on its own or as part of another governing provision); and (b) ending on the date on which the non-identical governing provision was removed or modified in a manner such that the governing provision complies with the one class of stock requirement.

Additionally, with respect to the S corporation not having made, or having not been deemed to have made, a disproportionate distribution to an applicable shareholder, this may still create some uneasiness with taxpayers and their practitioners – particularly in due diligence situations – as it may not always be clear as to when a potential disproportionate distribution may have occurred. For example, as discussed above, employment agreements between the S corporation and shareholder-employees that may ultimately be determined to provide excessive compensation to the shareholder-employee could be viewed as a disproportionate distribution.

Notwithstanding the above, and assuming the S corporation and the applicable shareholders meet requirements (i) through (iv), as outlined above, the retroactive corrective relief procedures include preparing various corrective relief statements, including a "Corporate Governing Provision Statement," as well as a "Shareholder Statement," explaining why the non-identical governing provisions were adopted, how they were discovered, and how they were corrected or removed. Appendix A of Rev. Proc. 2022-19 provides sample of both statements. While the Corporate Governing Provision Statement must be signed by a person authorized to sign the S corporation's federal income tax return, and the Shareholder Statement must be signed by each applicable shareholder – both under penalties of perjury – there is no requirement to actual submit the statements to the IRS. Rather, the statements, as well as the revised governing provisions, must be retained by the S corporation for inspection by authorized Internal Revenue officers or employees, and must be retained so long as the contents thereof may become material in the administration of any provision of the Code or the Income Tax Regulations.

As discussed above, Rev. Proc. 2022-19 fills some of the gaps that were not otherwise covered by Rev. Proc. 2013-20, although there may still be instances in which neither revenue procedure will apply, and thus the only relief that may be available will be requesting a private letter ruling from the IRS. Nonetheless, Section 4 of Rev. Proc. 2022-19 lists areas in which private letter rulings will not be issued, for example, in situations regarding the one class of stock requirement where the determination of the existence of a principal purpose is inherently factual in nature. Taxpayers and their advisers will have to evaluate each situation separately, based upon the particular facts and circumstances, to determine which, if either, of the revenue procedures may apply, and then which particular action(s) must be taken to cure the problem.

Banks Need a Game Plan to Keep Your Best People

By: Ken Derks and Trey Deupree, consultants with NFP Executive Benefits

In today's rapidly changing and competitive banking environment, attracting and retaining top performers is essential for success. In fact, it may be the key to differentiating your bank from your competition.

Some top challenges facing Texas bankers were recently identified in the 2022 TBA Bank Compensation and Benefits Survey*. The top three issues identified by survey participants include: finding and hiring the right people at 96%, followed by retaining and motivating the right people at 89% and motivating employees for better performance at 89%. Interestingly, these are the same top challenges as reported in TBA survey the previous three years, however, the top issue has increased in importance from 2021.

Retaining younger talent also continues to be a challenge, 63.3% of TBA survey respondents indicated it was "very or somewhat challenging" to retain younger talent up from 46.5% in 2021.

Bankers have made significant adjustments to salary for various employees. The survey did reflect that the base pay on average increased 8% up from 3% in 2021 for employees who met expectations while for top performers base pay increased at a rate of 10%, up from 6%. The average salary increase for officers was 6.8% in

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2022 up from 3.7% in 2021 and is projected to be 4.1% for 2023. Your bank may have made similar changes to retain certain key employees.

Banks, including Sub Chapter S banks with higher retention rates typically offer at least two to four of the following types of compensation plans, in addition to salary and bonus:

1. Employee stock ownership plans (ESOPs)
2. Equity Plans, such as stock options, restricted stock, phantom stock, and stock appreciation rights (SAR)
3. Supplemental Executive Retirement Plans (SERP)
4. Deferred Compensation Plans (DCP)

The design flexibility of these plan types can provide for payments to participants either at retirement or while employed. In some cases, banks will offer a combination of both in-service and post-retirement distributions.

The ability to customize such benefit plans has emerged as an important strategic tool to incentivize strong performance while fitting the demographics and needs of the key personnel regardless of age or life stage. There is no one-size-fits-all plan.

To help you develop a game plan for recruiting and retaining your best people, we have identified and discuss three key approaches below.

Incentive Programs

Sharing value with those who help create value is a common characteristic among high-performing banks. Top individual performers are looking for the right balance between guaranteed and variable compensation as well as between both short and long-term incentives. While objectives differ from bank to bank, every board should be able to identify the particular outcomes it wants to pursue and how their fulfillment will impact the financial future of the bank.

An effective incentive plan should have measurable goals and specific rewards tied to achieving those goals. They should include a blend of bank goals that the individual can help shape as well as individual goals. The key employee must be able to make a difference and see how his or her actions affect the outcome.

Strategic Deferred Compensation Plans

DCP's are used when a bank wants to create both a recruiting and retention incentive for top talent. A strategic and customizable deferred compensation plan is fully funded by the bank and should be based on performance criteria designed to support bank strategic goals. DCP's are not usually "all or nothing" in nature. In other words, there is a range of contribution levels tied to achieved performance levels, including no contributions in down years. Strategic DCP's can allow for contributions to be credited to balances based on ROA, ROE, or a phantom stock price, thereby tying the long-term value of contributions to the performance of the bank.

DCP's typically incorporate a vesting schedule to incent a participant to remain employed in order to reap the full benefits of the plan. When done right, DCP's create strategic alignment between a bank's board, shareholders, and its top management talent.

For younger generations, boards should consider a feature that allows for in-service distributions. In-service DCP payment schedules are customizable and can be made at any point, e.g., three, five or ten years to coincide with certain life events such as a home purchase, student loan repayments or a child entering college.

Equity Participation

Equity plans can be an important part of an officer's compensation package. However, many privately owned banks are reluctant to share actual equity with their employees. An alternative strategy to sharing real shares is a deferred cash bonus plan that is tied to appreciation of the bank's value over time.

Phantom Stock/Stock Appreciation Rights (SAR)

Phantom stock and SAR's are ways to provide an equity-like benefit to employees without having them own actual stock.

These plans are designed to pay key officers bonus compensation tied to an increase in the bank's stock or book value. In a SAR plan, the bank determines a hypothetical stock price through an internal or external valuation of the bank. Officers are awarded some number of hypothetical or "phantom" shares that include specific terms and conditions. At a pre-determined time, the officer receives a cash payment equal to the difference between the original price and the appreciated price.

For example, let's assume the officer receives an award of 1,000 phantom shares with a per share value of $50, and at the end of three years the bank calculates the per share value to be $75. This per share gain in value of $25 ($25,000 total) would then be paid to the officer.

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Now is the Time to Prepare

The current banking environment poses many challenges in the battle for management talent. Bank leadership should be proactive in taking steps to attract and retain the best people. Often times, the greatest risk to an institution is the risk of doing nothing. This axiom holds true particularly during times of uncertainty.

Compensation should be viewed as an investment in your people and franchise and not simply an expense. If your bank has not undertaken a formal review of the competitiveness of its compensation program for officers in recent years, now is the time.

**Source: the survey of Texas Bankers Association banks was conducted by Crowe, LLP with data collected as of March 2022.*

Ken Derks and Trey Deupree are consultants with NFP Executive Benefits, which both the ABA and TBA endorse for executive and board benefits consulting, administration of BOLI and nonqualified benefit plans, BOLI portfolio solutions and BOLI risk assessment. Derks and Deupree are registered representatives with Kestra Investment Services, LLC, Member FINRA/SIPC. NFP and Kestra Investment Services are not affiliated. To learn more, contact Ken Derks at ken.derks@nfp.com *or Trey Deupree at* trey.deupree@nfp.com.

Investor Disclosures: https://bit.ly/KF-Disclosures

Main Street Tax Certainty Act of 2023 Introduced

Senator Steve Daines (R – MT) a steadfast supporter of small business introduced the Main Street Certainty Act of 2023, a bill in the Senate on May 18, 2023 to extend Section 199A of the IRC, the provision that provides a 20% deduction to shareholders of a subchapter S bank or other pass through entity.

Cosponsor include: Senators Kevin Cramer (R-ND), John Barrasso (R-WY), Bill Hagerty (R-TN), Marsha Blackburn (R-TN), Bill Cassidy (R-LA), Roger Marshall (R-KS), Katie Britt (R-AL), Mike Braun (R-IN), Chuck Grassley (R-IA), Thom Tillis (R-NC), Tim Scott (R-SC), Ted Cruz (R-TX), Jim Risch (R-ID), and Roger Wicker (R-MS).

Senator Daines' office provided the following information release.

Effective for tax years after December 31, 2017, Section 199A of the Internal Revenue Code of 1986 allows non-corporate taxpayers to deduct a portion of their qualified business income.

The deduction for any taxable year is equal to the lesser of

(A) the combined qualified business income amount of the taxpayer, or

(B) 20% of the excess (if any) of the taxable income of the taxpayer over the net capital gain of the taxpayer.

Section 199A (i) sets the section to expire on December 31, 2025.

Over 140 trade associations added their names to a "strong letter of support" for the bill, including the S Corporation Association, the U.S. Chamber of Commerce, and the National Federation of Independent Business. The letter emphasizes that individual- and family-owned businesses are still recovering from the effects of COVID-19, such as price hikes, labor shortages, and supply chain disruptions. Without these businesses, communities may face lower growth, fewer jobs, and "more boarded-up businesses."

The letter also cites separate studies conducted by economists Barro and Furman, the American Action Forum, and DeBacker and Kasher, which have shown "improved parity and lower rates" as a result of the permanent deduction.

- The National Federation of Independent Business calls their readers to action in supporting the "crucial legislation," which companies nationwide have used to reinvest in their employees, benefits, and businesses.
- The National Association of Professional Insurance Agents has also released a statement supporting the Main Street Tax Certainty Act of 2023 because of the "predictability in tax liability" that it will bring to eligible entities.
- The S Corporation Association congratulates Senator Daines on introducing the "necessary" legislation that will allow businesses to "plan for growth with more certainty."
- The American Hotel and Lodging Association President and CEO, Chip Rogers, applauded Senator Daines, deeming the legislation "critical" for hotel

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small business owners to continue "investing, building, and creating jobs."

- The National Waste and Recycling Association backs the bill because it allows small businesses to "remain competitive."

It is anticipated that an identical bill will be introduced in the House. Ways and Means Committee Chairman Jason Smith sponsored the identical legislation last Congress with Rep. Henry Cuellar (D-Tx).

Practical Guidance: The Technical Side of Compliance

By: Haley Metteauer, Editorial Director, Association for Data & Cyber Governance

Recently, Forbes released an article titled 13 Tech Experts Explain Essential Facts About Data Privacy And Data Protection, in which "13 members of Forbes Technology Council further explore and explain data privacy and data protection, their differences and their impact on businesses."

ADCG has created guides and explainers for most if not all of the concepts explored in this roundup. We've summarized Forbes' points here, and linked to further reading on ADCG's site.

1. True Data Protection Requires Securing Every Point Of Entry

Roger Northrop, the chief technology officer (CTO) of Mutare, Inc. points out that a complete and effective data security process requires companies to "secure every single point of entry" in their information systems.

The first practical step in meeting this security standard outlined by Northrop is to analyze your company's current cybersecurity and data governance practices. To get started, check out ADCG's guide: Cybersecurity Checkup: 5 Steps You Can Take Now.

2. Data Protection Covers The 'Technical' Side Of Compliance

Northrop and Clément Stenac, the CTO of Dataiku, both stated the differences between data privacy — being the standard of access to certain data collected or stored by an organization — and data protection — which is the actual process for and the procedures and tools used to ensure that this data stays technically protected. However, Stenac noted that they are overlapping by nature as "data protection is the 'technical' part of the 'legal and compliance' elements defined by data privacy." To read more about the latest data protection tools, click here.

3. Data Privacy Encompasses Consumers' And Partners' Rights To Manage Their Data

According to Jamilia Grier, founder and chief executive officer (CEO) of ByteBao, data privacy for your organization should encompass company policies for both keeping certain information private, and managing a consumers' right to review, modify, or erase this private data.

This is one thing that has been made increasingly clear over the last few years as several states have adopted legislation requiring covered organizations to include procedures for maintaining and responding to these consumer rights. Check out the following guides to state laws from ADCG: Virginia Becomes Second State to Enact Comprehensive Privacy Bill; A Guide to Utah's Data Privacy Act; CPPA Releases Draft Regulations of CPRA; and CPRA Training Requirement. And search our "News and Resources" section for your state:

4. Data Protection Requires Infrastructure Managed By Qualified Engineers

Oleg Lola, Founder and CEO of MobiDev, says that in order to actually protect your organization's data, you need a qualified engineer to oversee your process and ensure that the data is stored safely and secured properly. And, as we discussed in our recently released ADCG Article: Employee Privacy to See Advances in 2023, finding or maintaining these qualified engineers may present your organization with some challenges this year. And if you're looking to rethink your data infrastructure, consider reading about Why Your Organization Should Invest in Confidential Computing.

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5. Modern Data Privacy Is Moving Toward Limiting Data Collection And Storage

Cyril Korenbeusser, Chief Resilience Officer (CRO) of BNP Paribas, notes that we have recently trended away from the idea that the more data a business can accumulate on a consumer, the better it can serve that consumer. To learn why, check out: Why Organizations Need to Start Implementing Data Minimization.

6. Data Privacy And Data Protection Are Both Key To Building Brand Trust

While Dale Renner, the Founder and CEO of Redpoint Global Inc., agreed with Northrop and Stenac's approach of distinguishing data privacy and data protection, he acknowledged that both elements are "key to building and maintaining trust with consumers, which will result in a strong and secure brand reputation." That's partly why Why 83 Percent of Financial Organizations Plan to Invest in Data Rights Management

7. Data Privacy Is Something Every Employee Is Responsible For

Jeff Fettes, CEO of Laivly Inc., proposes that a proper data privacy process requires "day-to-day proper handling of personally identifiable information[.]" While this can be challenging to accomplish, if your organization is larger and handles personally identifiable information (PII), Fettes encourages the use of an external auditor to ensure this day-to-day management is being achieved. And don't forget, Cybersecurity Training is Important for the Whole Organization

8. Data Privacy Is About Access; Data Protection Is About Security

Laureen Knudsen, chief transformation officer (CTrO) of Broadcom, boasts the importance of data privacy and data protection as they can gain and keep the trust of your customers, vendors, and employees. But what happens when a breach happens anyway?That's why we have cybersecurity frameworks—and an ADCG explainer: How Cybersecurity Frameworks Can Protect Your Organization (Even in the Event of a Breach).

9. Data Privacy And Data Protection Work Together To Protect Companies From Risk

Neil Lampton, President and Chief Operating Officer (COO) of TIAG, stated "data privacy and data protection are different sides of the same coin[,]" both of which "are important and necessary to keep a business running smoothly and to protect companies from risks." Our explainer on NIST's guide for assessing risk can help you get started.

10. De-Identifying Data Helps Address Both Privacy And Protection

James Beecham, Founder and CEO of ALTR, stated the importance of de-identifying consumer information to ensure data privacy as ensuring a consumer's privacy "is a commitment to customers that must be honored."

To learn more about de-identifying your company data, review these ADCG Articles: Why Your Organization Should Invest in Confidential Computing; Data Classification; ADCG Explainer – Polymorphic Encryption.

11. Data Privacy Applies To Highly Sensitive Data; Data Protection To All Data

Suresh Sethuramaswamy, Engineering Lead at Microsoft, stated data protection requires "[a] combination of techniques" to ensure "maximum protection from ransomware, data leaks, accidental damage and so on." Data Privacy, on the other hand, can be accomplished through "ensuring limited data collection, establishing highly restrictive access controls and meeting compliance requirements." Our explainer on clean rooms offers some practical guidance for achieving both protection and privacy.

12. There Are Multiple Global Regulations Regarding The Collection And Sharing Of Data

Neelima Mangal, Global Head of Delivery of Nutcache, stated the "crucial" significance of both data privacy and data protection due to the related "legal ramifications and requirements[,]" such as Europe's General Data Protection Regulation (GDPR), and China's Data Security Law

13. To Ensure Both Data Privacy And Protection, You Must Monitor Your Entire Data Pipeline

Nicholas Domnisch, CEO of EES Health, encouraged organizations to approach monitoring their entire "data pipeline" by using end-to-end encryption. To read about Privacy by Design, click here.

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Gramm-Leach-Bliley Act Updates Take Effect Soon

By: Haley Metteauer, Editorial Director, Association for Data & Cyber Governance

On November 15, 2022, the Federal Trade Commission (FTC) announced it would delay the compliance deadline for certain provisions of its updated Safeguards Rule (Rule) to June 9, 2023.

The Rule, which was mandated under the 1999 Gramm-Leach-Bliley Act, "requires non-banking financial institutions, such as mortgage brokers, motor vehicle dealers, and payday lenders, to develop, implement, and maintain a comprehensive security program to keep their customers' information safe."

The Rule has been amended several times since its creation, and the most recent round, approved by the FTC on October 27, 2021 would update the Rule to "include more specific criteria for what safeguards financial institutions must implement as part of their information security program such as limiting who can access consumer data and using encryption to secure the data."

According to Reuters, these amendments "seek to enforce a more prescriptive Safeguards Rule," an acknowledgement of sorts by the FTC "that comprehensive information security programs must account for the size and complexity of users/organizations, nature and scope of the activities, and sensitivity of any customer information."

Many provisions of the amendments were effective within 30 days after being published in the Federal Register, while the below-outlined sections were set to go into effect on December 9, 2022. The FTC is now extending the effective date of these sections due to a reported "shortage of qualified personnel to implement information security programs and that supply chain issues may lead to delays in obtaining necessary equipment for upgrading security systems."

FTC Commissioner Christine S. Wilson also stated that this extension was necessary, "[d]espite assurances that financial institutions were already implementing many of the requirements of the amended rule or had sophisticated compliance programs that could easily adopt and pivot to address new obligations," due to the economic impact and burden that the proposed changes may have caused the covered institutions.

By the new June 9, 2023 effective date, financial institutions must develop an information security program that:

- Designates a qualified individual to oversee, implement, and enforce their information security program and—if an institution or service provider maintains the personal information of 5,000 or more consumers—will report on the program regularly, and at least annually, to the governing persons in the organization
- Develops a written risk assessment that identifies reasonably foreseeable internal and external risks to the security, confidentiality, and integrity of consumer information that could result in the unauthorized access of this information and assesses the company's established safeguards to control these risks
- Addresses how an institution will ensure that the information systems of their service providers are sufficient, such as conducting periodic assessments of the security practices of these service providers
- Establishes a process for evaluating and updating the information security program, as needed
- Requires the development of an incident response plan, if an institution or service provider maintains the personal information of 5,000 or more consumers.

The FTC advised in their announcement that the best way for financial institutions to prepare for these amendments to go into effect is to take action now to comply by considering your company's current information security practices, including, but not limited to which employees can access a consumer's sensitive information, whether or not sensitive information collected and stored in your system is encrypted, and whether your organization requires multi-factor authentication to access sensitive information. And, if your organization's practices are not sufficient to comply with these updates, updating these practices, as needed, and training employees to ensure compliance is achieved.

Considering the basis for the delay, covered financial institutions should begin their compliance efforts with the amended Rule as these types of changes often require an institution to expel significant effort and resources.

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SAVE THE DATE FOR THE

2023 ANNUAL CONFERENCE!

Join us for the 26th Annual Subchapter S Bank Association's Conference on October 19th and 20th 2023 at The Omni La Mansion del Rio in beautiful downtown San Antonio! Listen to the latest in strategies and tactics to improve bank performance and ensure ongoing compliance from the leading professionals in the industry!

Date: **October 19-20, 2023**

Location: **The Omni La Mansion del Rio in San Antonio**

For More Information:

contact Amy Willcox at awillcox@subsbanks.org

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