FINANCIAL SERVICES TRENDS

COVID-19 POLICY CHANGES: WHAT BANKS NEED TO KNOW!

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Impacts from the COVID-19 pandemic have reverberated across every part of the global economy. Small businesses are
struggling to pay their employees, banks are grappling with collapsing local economies, and many borrowers across the nation cannot meet their monthly mortgage payments.

Banks will play a critical role in supporting their communities through this crisis, and federal banking agencies and legislators want to provide them with the tools to do so.

Since the outbreak ground the nation's economy to a halt in March, a number of new policies have been introduced, aimed at both helping banks navigate the unique uncertainties brought on by this pandemic and providing relief to the larger economy.

Some of the most drastic changes are intended to alleviate issues around borrower difficulty servicing debt, as well as the banking regulatory requirements surrounding them.

CARES Act Relief for Loan Modifications and Troubled Debt Restructurings

Under the Coronavirus Aid, Relief, and Economic Security Act (the "CARES Act"), passed by Congress on March 27, 2020, banks must structure forbearance programs for federally-backed mortgages that will allow borrowers to defer payments for up to 180 days, which legislators may extend further if necessary. These forbearance programs will be available to borrowers who are experiencing hardships due to the COVID-19 pandemic.

The CARES Act also provides new guidance for financial reporting on loans that have fallen delinquent. When a borrower facing hardship from the pandemic falls delinquent, or if their loan terms are modified, resulting in a troubled debt restructure, their loan will not be reported as delinquent or as a troubled debt restructure, whether or not the loan is delinquent or non-performing. This change only applies to loans that were current as of December 31, 2019, and if the hardships where directly related to the pandemic. If a borrower was delinquent as of December 31, 2019 and they receive payment accommodations due to the pandemic, they will maintain their delinquency status prior to the COVID-19 impact if further delinquencies occurred because of the pandemic. Banks should properly evaluate the impact of these changes on the disclosure requirements discussed in ASC 310-10-50-31 through 50-34, relating to troubled debt restructures, and ASC 326-20-50-14/15, relating to delinquencies.

These reporting exemptions are in effect from March 1 until either December 31 or 60 days after the national emergency ends.

If a loan modification is not eligible under the CARES Act, the bank should continue to account for these modifications under Accounting Standards Codification ("ASC") subtopic 310-40.

Additional considerations on loan modifications and reporting for banks working with customers affected by the current pandemic were announced by an interagency statement on April 7. They are:

Credit Risk	Regulatory Capital	Nonaccrual Status and Charge-Offs	Discount Window Eligibility
The agencies' examiners will exercise judgement when reviewing loan modifications and will not automatically adversely risk rate credits that are impacted by COVID-19.	One-to-four family residential mortgages where the loans are prudently underwritten, and not 90 days or more past due or carried in nonaccrual status, will not result in the loans being considered restructured or modified for the purposes of their respective risk-based capital rules.	During the short-term arrangements discussed in this statement, these loans generally should not be reported as nonaccrual. During the short-term arrangements discussed in this statement, these loans generally should not be reported as nonaccrual.	Institutions are reminded that loans that have been restructured as described under this statement will continue to be eligible as collateral at the Federal Reserve Board's discount window.

CARES Act Relief on the Community Bank Leverage Ratio Framework

To incentivize community banks to continue lending during the crisis, the CARES Act also lowers the required community bank leverage ratio from 9% to 8%, starting in the second quarter of 2020 through the end of the year. Regulators hope this will help community banks focus on "supporting lending to creditworthy households and businesses" during the pandemic, according to a joint press release from regulatory agencies. The ratio will subsequently be increased to 8.5% for the calendar year 2021 and 9% thereafter. The CARES Act also calls for a two-quarter grace period for institutions whose leverage ratio falls no more than 1% below the applicable community bank leverage ratio.

CARES Act PPP Program Loans

In an additional step to encourage lending to small businesses, the CARES Act establishes that loans originating from the Paycheck Protection Program ("PPP") will have no credit or market risk and will carry a zero percent risk weight for capital purposes.

As banks prepare for a spike in call volumes from customers seeking forbearance agreements, regulatory agencies have announced that they do not intend to take supervisory or enforcement action against mortgage servicers for delays in submitting certain documentation to regulators, including annual escrow statements, early intervention and loss mitigation notices.

Regulatory Relief from Appraisal Requirements

Regulatory agencies also have begun to allow banks to close on most real estate transactions without first obtaining an appraisal, with deferrals up to 120 days after the closing of a residential or commercial real estate transaction. This interim rule, effective April 14 through December 31, 2020, excludes transactions related to acquisitions, construction, and development of real estate.

CARES Act Relief from CECL

Additionally, the CARES Act seeks to provide banks with optional temporary relief relating to the implementation of FASB Accounting Standards Update No. 2016-13 (“Measurement of Credit Losses on Financial Instruments"), including the Current Expected Credit Losses (“CECL”) methodology for estimating allowances for credit losses. The Cares Act indicates banking institutions are not required to comply with the standard during the period beginning on the date of enactment of the act. These provisions will remain in effect until the earlier of the date in with the National Emergencies Act terminates, or December 31, 2020.

One key consideration for banks that opt to elect CARES Act relief and do not adopt CECL during the period allowed by the act, is that this will have an impact of reducing the two additional years relief provided by the regulatory agencies in delaying adoption of CECL .

Regulatory Relief from CECL

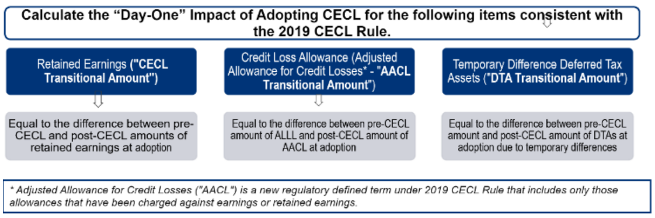
On March 31, 2020, in an additional step to provide regulatory relief, a joint statement by regulators including the Treasury, FRB, FDIC and OCC was made in the adoption of a CECL Interim Final Rule (“IFR”) which states that banks which were required to adopt CECL as of January 1, 2020 now have the option to delay reporting on the impact of CECL on regulatory capital for an additional two years, resulting in a total transition period of five years. This election can still be made for regulatory reporting even if the banking organization chooses to apply CECL pursuant to GAAP in 2020.

This five-year transition begins on the original CECL adoption date under U.S GAAP, regardless of whether the banking organization utilizes the regulatory relief. For a banking organization that utilizes the regulatory relief, and subsequently opts to use the relief provided in the CECL IFR, the initial two-year transition period would be reduced by the number of quarters during which the banking organization uses the statutory relief.

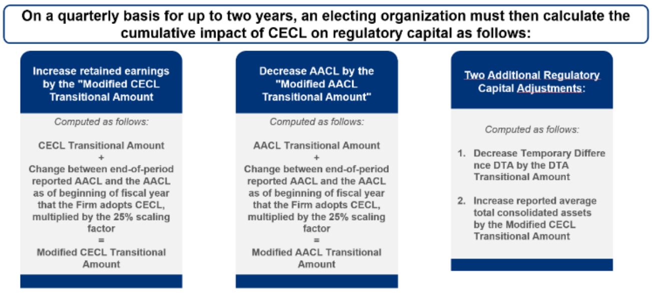
The CECL IFR, however, does not replace the current three-year transition option in the 2019 CECL Rule. This remains available to any banking organization at the time it adopts CECL. In addition, banks that opt to elect the CARES Act relief discussed above should note that such election will reduce the two additional years under the regulatory relief.

An additional provision within the CECL IFR released in 2020 introduces a 25% “scaling factor” for estimating the impact of CECL during the selected transition period. See the below three step approach to determining the estimate of the CECL impact, which includes the 25% scaling factor:

Step 1: Calculate day-one transitional amounts:



Step 2: Calculate modified transitional amounts, and the regulatory impact:



Step 3: Calculate the phase-in amount over the next three years, and the regulatory impact:

After two years, the cumulative amount of quarterly-modified transitional amounts become fixed and are phased out of regulatory capital along with the transitional amounts that were calculated to reflect the Day One impact of CECL.

The phase out occurs over the subsequent three-year period at following rates:

	Year 3	Year 4	Year 5
Increase retained earnings and average total consolidated assets by the following percentages of the modified CECL transitional amount……… Decrease temporary difference DTAs by the following percentages of the DTA transitional amount……… Decrease AACL by the following percentages of the modified AACL transitional amount………	75%	50%	25%

A key consideration in the process of preparing the first application of CECL is how the current economic environment will impact the estimates of CECL reserves. These should include:

- How temporary relief programs are changing the rule and impacting how assets are classified between sound, TDR and defaulted. This will have direct effects on the model calibration and should be considered when defining transition to default matrices.

- How current macroeconomic data will be impacted by the pandemic. Increases in unemployment, instability in certain counties/regions, and the expectation of a real estate property crisis should all be considered. These changes in the economic environment will affect the parameters used for the allowance calculation as the probability of default or the loss given default, as well as forward looking information weighting allocations to multiple scenarios used to estimate the reserve will be impacted.

SEC Relief Related to Regulatory Reporting

To help banks meet their regulatory obligations around high-quality financial reporting, the SEC announced on April 3 that the commission and staff are prepared to assist market participants with financial reporting issues such as:

Filing Extensions

Temporary 45-day grace period for registrants affected by COVID-19 filing exchange act reports due from March 1, 2020 through July 1, 2020

Disclosure Guidance

Provided guidance for companies as they assess COVID-19 related effects and other disclosure obligations including earnings estimates and non-GAAP financial measures disclosures

FASB Relief Related to Financial Accounting and Reporting

FASB has also considered the impacts of COVID-19 and intended to provide stakeholders with accounting relief and clarity on the effective dates of implementation of ASC 606 and ASC 842. On April 18, 2020, the FASB decided to add a project to its technical agenda to amend the effective dates relating to these standards for certain entities, as well as adding a research project to see if there are any opportunities to provide revenue recognition expedients to franchisors.

On April 21, 2020, the FASB issued a proposal that would grant a one year effective date delay for certain entities applying leases and revenue recognition guidance. The leases' effective date deferral would be limited to private companies, private not-for-profit organizations, and public not-for-profit organizations that have not yet issued their financial statements. Under the proposed Accounting Standard Update ("ASU"), private companies and private not-for-profit organizations would have the option to apply the new leases standard for fiscal years beginning after December 15, 2021, and to interim periods within fiscal years beginning after December 15, 2022. Public not-for-profit organizations that have not yet issued financial statements would have the option to apply the standard for fiscal years beginning after December 15, 2019, including interim periods within those fiscal years.

The proposed effective date deferral for revenue recognition would be limited to private company franchisors. Those stakeholders would have the option to apply the new standard for annual reporting periods beginning after December 15, 2019, and interim reporting periods within annual reporting periods beginning after December 15, 2020. FASB also discussed additional plans to support stakeholders with other standards that have effective dates of 2022 and beyond, as well as future standard setting activities for current project deliberations.

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