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ALERTS

Legislative and Bank Regulatory Actions to Assist Forbearance in a Pandemic World

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For the last three weeks or so, the federal and state banking agencies, collectively and individually, have, with increasing urgency, called on financial institutions to meet the financial needs of customers impacted by the COVID-19. Congress has now codified some of the guidance in the Coronavirus Aid, Relief, and Economic Security Act (CARES Act). To assist our clients in understanding the scale and scope of the regulatory actions, we describe the state of play as we know it today.

As first discussed in the article by our colleagues Neil Bloomfield and Kate Wellman, on March 9, the bank regulator community[1] issued a news release encouraging financial institutions to work constructively with borrowers and sought to assure institutions that examiners should not scrutinize such efforts, if done prudently. A central theme of the regulator's joint action is assisting and encouraging banks to forbear during the outbreak. The agencies have also encouraged banks to lend generally and aggressively, using capital the banks have built since that crisis. The agencies, and now Congress, have since reinforced the message in ways we have not seen since the financial crisis – and have even gone further than their actions in 2008. But, more may be needed.

Accounting and classification rules around loan modifications, troubled debt restructurings and nonaccruals, particularly with now-troubled borrowers, can be an impediment to banks' willingness to lend into a financial crisis. The agencies' position on the applicable rules and classifications have rapidly evolved to encourage lending, particularly loan modifications. To supplement their view of the applicable rules, the regulators have also sought to provide assurances to banks that they will not be subject to examiner criticism for taking reasonable actions to meet the outbreak. A summary of their some of the significant actions follows:

- OCC Bulletin - Pandemic Planning: Working with Customers Affected by Coronavirus and Regulatory Assistance March 13, 2020. The OCC emphasized that prudent efforts to modify terms for affected borrowers would not be subject to examiner criticism.
- Joint Release by banking agencies, CFBP, and the Conference of State Banking Supervisors – Agencies Provide Additional Information to Encourage Financial Institutions to Work with Borrowers Affected by COVID-19, on March 22, 2020. Again, the agencies strongly encouraged financial institutions to work constructively with borrowers and stated that they will not criticize institutions for doing so in a safe and sound manner. The joint release went further and stated that "Regardless of whether modification result in loans that are troubled debt restructurings (TDRs) or are adversely classified, agency examiners will not criticize prudent efforts to modify the terms on existing loans to affected customers."

In addition to the federal agencies the state banking departments are putting out guidance that mirrors and/or supplements the federal issuances. See, the Conference of State Banking Supervisors summary of state guidance. We will be continuing to evaluate the impact of those issuances on our clients.

Congress has also now acted in this important area through enactment of the CARES Act. Two provisions are of particular interest with respect to troubled debt restructuring:

- Section 1102(a)(2) establishes the Paycheck Protection Program which includes a small business loan program. Subsection (Q)(ii) states that with respect to bank capital requirements, a "covered loan" as defined in this section shall receive a risk rating of zero percent and further that financial institutions that modifies a "covered loan" as defined shall not be required to comply with the FASB standards regarding TDRs until such time and under such circumstances as the appropriate federal banking agency determines appropriate.
- Section 4013 would suspend accounting requirements for all loan modifications made between the period of March 1, 2020 to the earlier of December 31, 2020 or 60 days after the President' national emergency is terminated. The suspension of the TDR, and impairment accounting principles would be at the election of the financial institution but is only applicable for the term of the modification (and solely with respect to the modification). It also only applies to loans that were not more than 30 days past due as of December 31, 2019. Importantly (and to our recollection, unprecedentedly) the banking agencies "shall" defer to the determination of the financial institution to elect a suspension.

In addition to the actions taken with respect to troubled debt restructuring, Congress and the federal agencies have also taken action to assure that accounting requirements regarding the calculation of Current Expected Credit Losses (CECL)[2] do not become an impediment to lending.

- Section 4014 of the CARES Act - Financial institutions are allowed to not be subject to the CECL methodology for estimating credit losses from the date of enactment and ending on the earlier of December 31, 2020 or the date the President' national emergency is terminated.
- Interim Final Rule: Regulatory Capital Rule: Revised Transition of the Current Expected Credit Losses Methodology for Allowances, issued by the OCC, Federal Reserve, and FDIC on March 27, 2020. The interim final rule provides certain banking organizations that implement CECL before the end of 2020 the option to delay for two years an estimate of CECL's effect on regulatory capital, followed by a three-year transition period. The Interim Rule states that "the agencies are providing this relief to allow such banking organizations to better focus on supporting lending to creditworthy households and businesses in light of recent strains on the U.S. economy as a result of the coronavirus disease 2019 (COVID-19), while also maintaining the quality of regulatory capital."

In addition to forbearance, the federal agencies have also provided guidance and encouragement in other issuances. These include:

- Joint Statement on Community Reinvestment Act considerations when responding to affected borrowers and customers.

- Joint statement encouraging banks, savings associations and credit unions to offer responsible small-dollar loans to consumers and small businesses in response to COVID-19. In addition to encouragement to offer these loans, the agencies state that loans should be offered in a manner that provides fair treatment of consumers, complies with applicable laws and regulations, and is consistent with safe and sound practices. The statement notes that additional guidance is expected.

Key takeaways:

Prudent lending and loan modifications are strongly encouraged, and the examiners will not criticize good faith efforts. Accordingly, as this health and economic crisis evolves, banks will need to quickly develop programs to provide or modify loans to borrowers affected by COVID-19 either directly, or indirectly. And while we are reassured by the agencies' pronouncements regarding future criticism, particularly of loan modifications, and by Congress' mandate on deference regarding TDRs, it is important that banks make efforts to demonstrate that their programs, policies and procedures are sound. "Prudent" and "good faith" will be viewed not just in today's frame, but by tomorrow's perspective. In addition, some of the forbearance measures are temporary so banks need to consider the long-term impact as well.

Questions by examiners (and other oversight authorities) may arise once this crisis has subsided. Accordingly, we recommend that Board of Directors evaluate changes to loan programs, policy and procedures that would implement these new lending and modification programs. Individual loan decision should be guided by the agencies' issuances as well as prudence. For example, banks should consider how best to document borrowers' financial soundness prior to being affected as well as any measures being taken by borrowers to mitigate losses will be useful in documenting a bank's assessment of the modification. And as a cautionary point, in addition to individual loan decisions, it will be important to ensure that these programs and procedures do not have disparate impact on borrowers.

Finally, as noted above, much of the forbearance thus far has been focused on loan modifications. And while the agencies continue to reinforce the message that new loans to affected customers is strongly encouraged, it is not yet clear how good faith efforts in direct lending will be evaluated. This is an area we could expect to see additional guidance in the near term. Accordingly, as the Congress and the agencies continue act, we will provide updates.