Dealing with Pandemic Disruption

By: Bill Elliot, CRCM, Director of Compliance Education, and William J. Showalter, CRCM, CRP, Senior Consultant, Young & Associates, Inc., Kent, Ohio

For years banks have had pandemic policies, and have done some level of testing, but never really thought the day would come when it would represent more than another examiner-required policy. Then came COVID-19, and in a matter of days, our world changed.

Managing Bank Policies and Procedures
When we teach in live seminars, we always ask, "How many of you believe that your policies are up to date?" That always gets some hands, but not 100 percent of attendees. Then we ask, "How many of you believe that your procedures are up to date?" Seldom does anyone raise their hand. These two situations are revealing.

Keeping policies current is the easier of the two. But many banks rubber stamp policies that could be much more effective. If it is a Regulation B policy, it usually follows the regulation and indicates that the bank intends to comply. But other policies, notably operations and loan policies, need to do more than restate a regulation – they need to be a document that can be read and used. And, a pandemic policy needs to cover a wide range of subjects and issues.

Given the current situation, it might be time to review these types of policies and add significant language as to how you will address situations such as we have now – lobbies closed or restricted, limited staff, staff working from home, and the same job to be completed. At a minimum, these policies should address:

- How jobs are done in an off-site world
- How electronic solutions are to be used
- Safeguards that must be used to protect customer data
- What types of paper documents can be used "at home" by staff working off site
- Proper disposal and the safekeeping of any documents that are off site, and
- Other protections, such as how the computers being used at home are protected from intrusion

With a little brainstorming, we are sure that you can add to this list.

Procedures are more difficult to maintain. A consultant from our company was recently in a bank and was examining procedures. Most of the procedures could be summed up as "Bill takes care of that." As long as Bill is there, things probably work well. But if Bill is out sick, on vacation, or no longer there, how does someone accomplish the task?

Procedures are always changing. It is far too easy to tell the three people that need to know about the change and then make a mental note to "update the procedures someday." That elusive "someday" often never materializes. We believe that each bank should have a formal procedures review at least annually, and for some areas, maybe more often. For many banks, the inadequate procedure manuals that they have will not offer sufficient information for anyone to complete a task correctly.

Many banks have switched to imaging all files. The banks that have made that decision generally are in a little better shape for off-site work, as it is easier to send employees home and still get the work done in a timely manner. If your bank has not made the transition to electronic files, this may be your cue to consider the advantages of this technology.

As the world becomes more electronic, and the cost of maintaining offices and buildings continues to increase, this may also be a time to reconsider the locations from which employees work. This may be especially critical if your brick and mortar buildings are getting close to capacity. Many tasks, with the right equipment and software, can easily be done from home, saving wear and tear on your building, perhaps reducing occupancy costs, and maybe, as a side benefit, resulting in happier and more productive employees.

Regulators and COVID-19 Loan Modifications

On March 22, 2020, all of the prudential banking regulators, along with other agencies, released the *Interagency Statement on Loan Modifications and Reporting for Financial Institutions Working with Customers Affected by the Coronavirus*. The full text can be found on many websites, however, the Federal Deposit Insurance Corporation (FDIC) has it at:

https://www.fdic.gov/news/news/press/2020/pr20038a.pdf

The document states, "The agencies understand that this unique and evolving situation could pose temporary business disruptions and challenges that affect banks…businesses, borrowers, and the economy. The agencies encourage financial institutions to work prudently with borrowers who are or may be unable to meet their contractual payment obligations because of the effects of COVID-19. The agencies view loan modification programs as positive actions that can mitigate adverse effects on borrowers due to COVID-19. The agencies will not criticize institutions for working with borrowers and will not direct supervised institutions to automatically categorize all COVID-19 related loan modifications as troubled debt restructurings (TDRs)."

The agencies also offered comments on the issue of TDRs. They state that, "Modifications of loan terms do not automatically result in TDRs…The agencies have confirmed with staff of the Financial Accounting Standards Board (FASB) that short-term modifications made on a good faith basis in response to COVID-19 to borrowers who were current prior to any relief, are not TDRs. This includes short-term (e.g., six months) modifications such as payment deferrals, fee waivers, extensions of repayment terms, or other delays in payment that are insignificant. Borrowers considered current are those that are less than 30 days past due on their contractual payments at the time a modification program is implemented."

Many banks have in place or are considering modifications to meet the needs of their customer base. It would appear that the regulators are going to react positively, provided the actions of the bank are reasonable and logical. The pronouncement states, "The agencies' examiners will exercise judgment in reviewing loan modifications, including TDRs, and will not automatically adversely risk rate credits that are affected by COVID-19, including those considered TDRs. Regardless of whether modifications result in loans that are considered TDRs or are adversely classified, agency examiners will not criticize prudent efforts to modify the terms on existing loans to affected customers."

The pronouncement also discusses Past Due Reporting, Nonaccrual Status and Charge-offs, and Discount Window Eligibility. You should consult the Interagency Statement for details.

When implementing your program to deal with this crisis, compliance cannot be ignored. Regulations that need to be considered include:

- Regulation B (Equal Credit Opportunity Act) – This applies to both consumer and commercial loans.
- Flood insurance regulations – If you extend maturity dates, a new determination may be required. This also applies to both consumer and commercial loans.
- Regulation O (Loans to Insiders) – If anyone who is an "insider" is requesting payment or other forms of relief.
- Regulation X (Real Estate Settlement Procedures Act) – You need to consider the impact of non-payment into required escrow accounts.

CRA Credit Possible

The Community Reinvestment Act (CRA), in part, requires banks to take good care of the credit needs in their communities. Keeping good records of exactly what you did during this crisis could certainly be shared with your CRA examiners at your next CRA examination. While it may not directly impact the examination, remember that the CRA rating is at least partly based on their opinion of your bank.

The FDIC, Federal Reserve Board (FRB), and Office of the Comptroller of the Currency (OCC) issued a Joint Statement on March 19 stating that the agencies will favorably consider retail banking services and retail lending activities in a financial institution's assessment area(s) that are responsive to the needs of low- and moderate-income (LMI) individuals, small businesses, and small farms affected by COVID-19 and that are consistent with safe and sound banking practices. The agencies emphasize that prudent efforts to modify the terms on new or existing loans for affected LMI customers, small businesses, and small farms will receive CRA consideration and not be subject to examiner criticism.

Impact of Accommodating Distressed Customers

There will be long-term consequences for any decision you make to alter a contract. For instance, if you allow a customer to skip a payment completely and do not change the maturity date, you will have a balloon at maturity. And since interest continues to accrue for that extra month(s), the principal/interest calculation will likely not be quite correct. So even if you do extend a maturity date, you may have a balloon simply because of the principal and interest calculation.

Having that discussion with your customer now seems preferable to fighting about it in a few years. The only real solution to assure that the loan amortizes correctly is to do the analysis to determine what payment amount will be required to avoid a balloon. And even then, things may still go awry at maturity.

Future Developments

As with many things today, this whole issue continues to evolve. The agencies had planned to present a webinar on this interagency statement on March 27, but have postponed it as of this writing. Keep on the lookout for further word from the agencies on when this will be available.

There is also a Frequently Asked Questions (FAQ) document available at https://www.fdic.gov/coronavirus/faq-fi.pdf, to provide some clarification regarding the interagency statement.

Conclusion

We hope that this article helps you to address these issues. We encourage you to consider what your situation will be post-crisis, as it will likely have lasting impacts on your bank. Try to assure that the lasting impacts are positive, as we all learn from the experience how to handle future disruptions (should they occur) with even more professionalism.

For more information, contact Bill Elliott, Director of Compliance Education, at bille@younginc.com or 330-422-3450, or William Showalter at wshowalter@younginc.com or 330-422-3473.

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