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Bank & Finance

An Overview of Current Banking Developments and Advice from a Former Regulator and Veteran of Past Economic Cycles

Legal Update

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Our industry has continued to evolve this past year. As of the FDIC's most recent quarterly report on the industry, we are now down to 5,066 FDIC insured commercial banks and savings institutions; that compares to 5,303 in June of 2019. The number is being driven by consolidation of charters. Even though *de novo* activity has continued to increase over the past year, new charters are not filling the gap. In 2006 there were 267 new banks; by 2011 that number had dropped to zero. The FDIC approved nine in 2019, with nine new applications pending as of September 29, 2020. However, a key issue is how the pandemic and economic conditions may affect the trendline. For example, the Texas Banking Commissioner recently denied a pending *de novo* application citing concerns over the proposed bank's probability of success.

A second key issue related to *de novos* is who is applying. Fintechs lead the headlines with continued controversy over entry – whether they should be able to charter an industrial loan company, obtain a full bank charter, pursue the new proposed OCC special purpose charter or payments charter, or acquire an existing bank charter. Credit unions are also in the headlines as a new player in the bank M&A market, picking up whole banks as well as branches.

On the regulatory front, headlines include CRA reform, "covered savings associations," various regulatory initiatives focused on how technology is changing and challenging the industry, and ongoing tension and interplay between federal and state regulation such as California's new Department of Financial Protection and Innovation – the so-called mini CFPB. Loan developments include LIBOR, PPP loans, the valid-when-made/Madden fix, forbearance, the ag economy, and the great unknown as to what bank loan portfolios will look like by the end of the year. Right now, the number of institutions on the FDIC's "Problem Bank List" has declined to 52, falling to a near historic low. The industry has strong liquidity and capital, but net interest margins have declined, and nonperforming assets have inched up, leading to two out of every three banks reporting yearly increases in provision for credit losses.

Given current conditions and uncertainties, bank boards and management should hope for a vaccine, a strong economy, and world peace, but prepare in case any of that is not achieved in the near term.

First, be mindful that the current regulatory climate could change quickly. I agree with and applaud regulators for encouraging banks to work with their customers and for not telling banks to automatically downgrade loans and book TDRs. However, I have been though many economic cycles and, as a result, worry that banks will be caught off guard and criticized by regulators, in hindsight, for failing to act swiftly and aggressively on problem loans. For example, in the FDIC's FIL 64-2020, titled "The Interagency Examiner Guidance for Assessing Safety and Soundness Considering the Effect of the COVID-19 Pandemic on Institutions," there is a sentence that says, "when rating an institution's management, examiners will distinguish between problems caused by the institution's management and those caused by external factors beyond management's control." The FFIEC Business Continuity Manual Booklet does not reference risks beyond management's control, but "reasonably foreseeable events" that are expected to be foreseen and risk-assessed by management.

As bankers, how do you reconcile these two seemingly different concepts/ guidelines? My advice is to carefully monitor and assess the risk and document the decisions you are making on credits in light of current conditions and regulatory guidance so that, if questions are raised in the future, you have a paper trail supporting your decisions.

Second, pay close attention to CRA and fair lending. These areas will continue to receive close attention and heightened expectations by regulators in light of current events.

Third, if you have customers and active operations in multiple states, determine whether you are subject to any state laws and regulations beyond those of your home state. There have been a number of recent state law developments related to privacy and consumer protection. You should assess whether they arguably apply to your organization.

Fourth, assess your insurance coverage. As you may recall, several carriers dropped coverage and significantly increased prices during the financial crises. Accordingly, now is the time to evaluate and perhaps increase current coverage both in terms of type and amounts.

Fifth, reassess your strategic plan. Challenging times bring opportunities. Determine what course is best for your organization to increase shareholder value, and then position your organization for whatever that course may be. For example, do you want to expand through acquisition, open new *de novo* branches, or close branches? Alternatively, do you want to position your organization for a potential sale? Depending on your strategic plan, the decisions you make on everything from technology to hiring may be very different.

Sixth, if you have not already done so, increase capital cushions.

Seventh, assess whether you have the right staffing resources. Having the right people in the right places is the strongest defense and offense in tough times.

The industry has weathered much in the past. I have confidence that it will do so again given the strength and dedication of the men and women who oversee, manage, and work for America's banking institutions, as well as the regulators, trade associations, and professionals that support the industry.