

## Record of Meeting

### Community Depository Institutions Advisory Council and the Board of Governors

November 19, 2020

1. **Current Banking Conditions:** *What is the Council's view of the current condition of, and the outlook for, loan markets and financial markets in general? Please describe the general impact on community depository institutions of the lending and liquidity facilities established pursuant to the CARES Act, the level of traditional (non-CARES Act) loan demand, and what the Council sees as the prospects for lending going forward.*

Council members reported that loan markets have largely remained stable, though certain sectors and regions have been more adversely impacted than others. Credit availability has held steady and underwriting criteria, which tightened at the beginning of the crisis, have returned to pre-pandemic standards in most regions. Loan demand remains mixed across geographic areas and sectors. Council members have seen softer loan demand in the industries that were hit hardest by the virus, such as hospitality, retail, and commercial real estate. Demand for construction and residential real estate lending, though, has increased—driven by households' exodus from urban centers into suburban and rural areas.

There is growing concern about the ability to assess borrowers accurately going forward. Given ongoing uncertainty about future federal stimulus and the trajectory of both the pandemic and economic recovery, institutions fear current conditions cannot be used to project future default risk. Going forward, lending will be highly dependent on the course of the virus, local and state restrictions, and the potential for additional government stimulus.

- a. **Small Business Lending:** *Have small business credit availability and demand changed significantly? Have lending standards for these borrowers changed given the impact of the pandemic on small businesses?*

Council members noted that while small business credit availability has held steady, credit demand has largely softened. Credit demand has been geographically dispersed, with demand generally more robust in urban than in rural areas. Alaska and Hawaii have seen larger negative impacts from the downturn than in the contiguous states. Several Districts observed sector-specific spikes in industries that have been positively impacted by the pandemic, including grocery stores and pharmacies.

Council members reported softened credit demand across most parts of the country. However, strengthened demand has been seen in the Eighth District, with corresponding pressure on pricing and terms. In some cases, delayed appraisals have constrained credit extensions, and economic uncertainty has made appraisals less predictable.

Credit underwriting standards in other parts of the country have largely remained unchanged. However, the Seventh District has seen tightened lending standards, with

lenders are asking for more frequent financial statements and other information from borrowers to assess risk. As stated above, there is growing concern about the ability to assess borrowers accurately going forward. While small businesses have fared better than Council members expected at the start of the crisis, lenders are uncertain whether the firms have been propped up by government support, and what the true impact of the pandemic will be as that support runs out.

- b. *Commercial Real Estate Lending:*** *Have there been any changes in the Council's view of challenges in the commercial real estate market in view of the pandemic's impact? How are commercial real estate loans performing compared to the Council's expectations?*

Commercial real estate (CRE) lending demand is dependent on geography and the impact of pandemic shutdowns. COVID-19 impact could account for variations in urban, suburban, and rural markets. Overall, demand is moderately weaker in many urban areas as well as in some industry segments impacted more deeply.

There is uncertainty in particular verticals—owner occupied properties are performing better than non-owner-occupied properties. The hospitality, retail, and recreation, segments have generally been hit hard. However, there is a rebound for seasonal lodging properties that have outdoor services and are accessible within driving distance, versus flying to a destination. The rebound has mostly been in properties not dependent on convention bookings. Healthcare has suffered in earnings and personnel layoffs as elective treatments have plummeted. There is future concern for office space as the market is adapting to a larger work-from-home environment. Multifamily properties are performing fairly well, however; there are concerns regarding the decrease in rental prices and the increase in vacancies, due to the exodus from urban centers to the suburbs and exurbs. Community depository institutions' (CDIs) flexibility and ability to work with borrowers through the pandemic has proven to be an advantage. In contrast, large properties are more dependent on syndicated loans and national credit terms.

Most CDIs are liquid and well capitalized, causing strong competition for high-quality CRE credits, which drives prices down and pinches net interest margins.

- c. *Construction Lending:*** *What are Council members' perspectives on the availability of credit for construction and development projects? Have Council members seen any changes in the demand for construction loans since the beginning of the pandemic?*

Large banks have pulled back on construction lending providing an opportunity for community banks that also brings incremental risks. There is a slight increase in lending in some markets, but not for land development or speculative building. The exodus from many COVID-impacted cities to rural areas, which have been viewed as safer environments, has increased construction lending in these geographies. In some cases, lot and building-permit availability is limiting the building activities. Lending for home improvements and additions has increased, both for customers staying in place and those who are part of the exodus. Adding home office space is also common. Construction in existing homes is sometimes funded with home equity loans,

cash-out refinances, or home improvement loans. For rural areas, there is potential demand to develop larger tracts, although availability of high-speed internet for virtual school and work-from-home environments is a limiting factor.

- d. ***Home Mortgage Lending:*** *What changes have Council members seen in the mortgage market? Is a trend developing among community banks to increase, decrease, or cease home mortgage originations? If so, to what extent is the pandemic driving the trend, and what do Council members see as its ongoing effects?*

The low interest rate environment has caused a historic spike in home refinances and home purchases. Some banks report that they are having the highest loan origination volumes ever. Limited inventory of homes for sale is constraining the purchase market in every District.

Districts most heavily impacted by the economic shutdowns and widespread infection rates are seeing the largest migration from urban areas to suburban, exurban, and rural areas. Borrowers are generally seeking greener spaces and larger homes. Some banks have reported significant in-migration from out-of-state populations due to economic shutdowns in other states and businesses moving to their state. All of these factors have resulted in an increase in home prices and have determined which geographies have the hottest pricing.

Some banks reported a strong increase in competition for staff, with intense market demand for underwriting professionals and loan officers, resulting in 30-40 percent increases in salary offers.

In addition, banks reported cash-out refinances and home equity lines were often used to fund additions to current homes.

- e. ***Consumer Lending:*** *What changes have Council members seen in consumer lending through the course of the pandemic?*

Council members observed an increase in the use of home equity lines of credit (HELOCs) to finance home improvements, as consumers quarantine inside and seek to better equip their home offices, build pools, and make other improvements to their homes. However, Council members noted a runoff of HELOCs as people have begun to wrap them into home refinancings.

Council members reported a significant shortage in used vehicles in some areas, and all Council members saw an increase in purchases of recreational vehicles, such as ATVs, snowmobiles, boats, and RVs. In the Ninth and Tenth Districts and elsewhere, dealerships are facing challenges restocking inventory.

Credit unions are reporting good, and even record, years in some cases, but banks have seen less growth, often attributed to consumers' flush cash positions as a result of stimulus money and other forms of fiscal support. Often, consumers are paying down debt, and in the last several months, certain delinquency rates have improved (noted in the Third District).

*f. Agricultural Lending: Have there been any changes in agricultural lending?*

Crop prices have continued to decline, and consolidation has continued to reduce the number of small farm operations. This trend has been ongoing for several years with the growth of foreign competition, and is mostly unrelated to the pandemic. However, Council members noted that, in the last 60 days, there has been a strong resurgence in the price of corn and soybeans that is expected to continue in the immediate future.

Council members expect the agricultural sector would have seen sizable losses in the absence of government support in 2020, which equaled roughly \$200 per acre, or 40 percent, of gross revenue. Livestock is particularly strained because of supply chain issues and rising grain prices, which are expected to continue.

The profitability for agricultural producers has been challenged over the past five years, exacerbated by high and rising land costs. This problem is more acute where agricultural land has attracted interest for alternative use. The Eleventh District, for example, saw a steady transition of agricultural land to other land uses. Depending on the geographies conducive to alternative development, such as transition from agricultural production to recreation, costs of land now exceed production capability. This is particularly true in areas of Texas that are experiencing a large migration from other states.

The Fifth District observed a resurgence in hemp production in the old “Tobacco Belt” (Virginia, North Carolina, and South Carolina). However, in the Eighth District, overproduction of hemp last year in states like Kentucky led to a decline in production for 2020.

*g. Deposits: Have Council members seen any changes in local deposit markets?*

Council members across all Districts reported strong deposit growth in their local markets since the onset of the pandemic. Council members attributed this growth to the Paycheck Protection Program (PPP) and businesses and consumers seeking the safety of banks to hold their funds.

The rise in deposit supply has driven deposit rates to negligible levels, which is a plus. The cost of funds is historically low, increasing spreads on existing assets, but the growth of deposits far exceeds opportunities to grow loan assets in a prudent manner. As a result, the Council reported that CDIs are widely deploying deposit funds to pay down Federal Home Loan Bank advances. Until deposit growth normalizes, accommodations should be considered for capital ratio treatment and deposit insurance assessments.

Council members are supportive of further stimulus that they expect will be needed to help otherwise sound consumers and businesses bridge the ongoing effects of the pandemic over the coming quarters. However, another round of federal stimulus that brings in more deposits could exacerbate the existing problems posed by high levels of temporary deposit growth. Council members will stand by to provide data and advice on these and other problems that may emerge.

## 2. Economic Discussion:

### a. *Overall Economic Conditions: How do Council members assess overall economic conditions in their regions?*

The Council members' outlook is mixed, encouraging for some industries but discouraging for others. Grocery stores and pharmacies are doing well. Hemp, CBD oil, and medical marijuana industries (where permitted) are prospering (except in Kentucky, which is experiencing a glut-driven pullback from hemp). The Twelfth District reports that logging is doing well. All Districts reported that the hospitality, restaurant, and medical (hospitals, doctors, dentists, optometrists, etc.) industries are generally weak. A major exception reported by several Council members is that drivable coastal and other recreational areas have seen a strong recovery, benefitting from an increase in short-range domestic travel not dependent on public transportation. Restaurants and hotels saw an up-tick in business over the summer that is now slacking off. Educational institutions are suffering losses, but not severely.

The Third District reported that urban tourists returned to higher-end resorts in the Poconos over the summer, spurring rehiring. In non-resort areas, employment has been hurt in tourism and the arts. Shale fracking has remained strong.

As in the past, Council members reported stronger growth in metropolitan regions—especially in suburbs and exurbs. However, cities and states that locked down for the pandemic are recovering more slowly. In contrast, most rural economies continue to stagnate. However, several Council members mentioned households moving out of cities to suburbs, exurbs, and rural areas, where families can find more land, open space, and larger homes. Moreover, acceptance of remote, work-from-home employees has spurred migration to rural agricultural areas--though migration is restrained where high-speed internet is unavailable.

Council members noted that bankers from across the country expressed uncertainty regarding the future. There is little confidence that the future will follow past trends, and all Council members expressed significant concerns about the prospects for economic recovery and credit quality without further government support.

### b. *Particular Indicators:*

*In answering each of the specific questions below, please note the impact of the pandemic on each topic or market segment.*

#### i. *Inflation: Are the prices of products and services rising (or declining) more or less quickly than in the recent past? Are the prices for the products and services Council members purchase rising more or less quickly?*

Council members noted that inflation has been restrained for most items. Prices for home improvement, lumber and other construction materials, and the related labor are exceptions. Moreover, some Council members reported that prices paid for farmland were rising to above the value of agricultural production, reversing past trends. For example, in the Tenth District, agricultural production prices are rising moderately but farmland values are experiencing stronger price pressure.

In the Eleventh District, values have increased for agricultural land that is suitable for alternative, higher-value development. Some of the latter shift has reflected pandemic out-migrations and the demand for easily reached open space and recreation.

ii. *Housing: How have home prices changed in recent months? Have there been any changes in overall housing activity in Council members' Districts?*

Council members from all Districts reported that home buying and price increases have been strong, spurred by mortgage rates near historic lows but restrained by supply shortages. The strength in housing has been more pronounced in suburban and ex-urban areas – but somewhat less in areas subject to social lockdowns. In the past, Council members have reported that shortages in affordable housing have priced some buyers out of this segment.

All Council members have seen moderate increases in homebuilding, hindered by shortages of labor, materials, and – most significantly – developable land. Construction is proceeding primarily for projects with permits issued before the pandemic and in suburban and ex-urban areas. There is little speculative homebuilding.

Despite rising home prices, many homeowners face conundrums. Those wishing to move are finding that the higher values of their homes are being offset or exceeded by the cost of homes in the areas where they wish to relocate. Rising home prices and the continued dearth of supply are exacerbating the perennial shortage of affordable housing. Some large cities have seen declining rents and home values because of out-migration this year. Higher suburban and ex-urban home values appear to correlate with declining urban rents within regions.

iii. *Labor Markets: How have the labor markets in which Council members operate changed in recent months? In particular, please assess the degree of job loss or gain (and, in which industries). What changes to wages have Council members observed over the past year?*

Growing acceptance of remote work is having widespread effects. In particular, salaries for better-educated, higher-wage employees are being bid up by out-of-market employers seeking remote workers. For example, in the Fifth District, a community college in South Carolina and a bank in the D.C. metro area have been fielding job applications from across the country for remote work. In the Seventh District, an in-house mortgage underwriter was hired away with a 30 percent wage premium to work remotely for a firm in another state. Remote work is also stimulating the movement of families to larger homes and more green space.

On the other hand, most of the job losses this year have been for low-paid workers, with many remaining out of work. Workers in hospitality, leisure, and retail continue to be the most impacted. For example, in Hawaii, 135 of 150 hotels are reported to have closed. Generally, there has been little wage pressure,

except for those with certain skills or in certain professions. Most Council members reported that add-on federal benefits appeared to have dis-incented some of the lower-income unemployed from returning to the labor force. In addition, lower-paid workers were often the first laid off and the least prepared to work remotely, increasing their hardship and dislocation.

- Workers in larger chains and business, as well as those in coastal and resort areas, have fared better. Firms in distribution and logistics (e.g., Amazon warehouses) are offering \$25 per hour as starting wages.
- A few Council members note that the pandemic has hastened digitization, rendering some roles in financial services redundant.
- School-at-home is a challenge for working parents. It has been difficult to find qualified childcare, and parents have pandemic concerns. Banks have tended to be flexible with employee arrangements.
- Larger banks in the Tenth District have started layoffs, leading to a surplus of white-collar workers.

iv. *Consumer Confidence: Are Council members seeing any signs of improved consumer confidence? What is the outlook for consumer credit losses?*

Council members noted that state and city lockdowns weighed heavily on confidence, but this was buoyed when areas reopened and the summer recovery was stronger than expected. However, confidence is dropping in areas where pandemic cases are spiking and lockdowns are returning. All agreed that there is much concern for next year. Some households have become less concerned about the pandemic and more concerned about whether or when there will be additional federal stimulus.

Council members noted significant disparities in consumer confidence dependent on education and skill level. Less educated, lower-skilled workers, who are largely still recovering from the labor market shock, tend to be more pessimistic. On the other hand, several Council members noted that households have, in general, begun to save less and spend more, suggesting that pessimism may be declining. In particular, consumer loans and borrowing for home improvements and recreational vehicles (e.g., boats, snowmobiles, all-terrain vehicles, and RVs) has been rising.

Council members noted a dichotomy between rural and urban areas in that urban areas appear less optimistic. Rural confidence has been buoyed by employees electing to move to second homes and work remotely, and to shop locally. Rural areas also are benefiting from people replacing international travel with domestic vacations.

**3. Community Bank Response to Challenges Faced by Customers:** *What is the Council's collective experience with delinquency rates and deferrals and other loan modification approaches, for both commercial and consumer lending customers, in light of the disruptive impact on those customers caused by employment challenges, operational restrictions, and social distancing?*

Council members noted uncertainty as a common challenge throughout the Districts, with difficulty forecasting the future of the pandemic being a particular concern. While loan performance varied among and within Districts, most Districts reported that the overall health of loan portfolios was stronger than anticipated. The Eighth and Tenth Districts noted especially strong performance. To the extent that individual institutions within the Districts faced increased delinquencies, those were correlated with heavy concentrations in loans to retail establishments, hotels, and restaurants.

Across the Districts, deferral levels were higher at the onset of the pandemic and have fallen considerably in subsequent months. The Districts noted the considerable likelihood that fiscal stimulus from earlier in the year has contributed meaningfully to the performance of loan portfolios across the country. To the extent further fiscal stimulus is not forthcoming, projections were that the second and third quarters in 2021 might show signs of portfolio deterioration.

Many Districts expressed concern about the differential impact of the pandemic, with certain businesses falling further behind as others found themselves more capable of adapting to modified operating environments. To the extent that certain businesses struggle and accrue additional debt burden, concern was expressed that sustainable modifications later may prove difficult.

However, the willingness of the Financial Accounting Standards Board (FASB) to recognize the unique nature of these times and afford greater flexibility on Troubled Debt Restructuring (TDR) classification was noted as a particularly significant and positive development, enabling financial institutions maximum flexibility in pursuing optimal workouts for distressed borrowers. Still, some Districts noted that client accommodations may soon be treated as a credit event that needed to be reflected on bank balance sheets.

Most Districts noted that a key borrower challenge related to the Paycheck Protection Program (PPP) pertained to the conversion of Economic Injury Disaster Loan (EIDL) funds into unexpected debt.

**4. Pandemic Paradigm Shift:** *Please comment on how practices have changed within Council members' institutions and between community depository institutions and their customers as 2020 has progressed. To what extent do Council members regard these changes as temporary versus permanent? What challenges do these changes present to business practices and the role of regulation and regulatory practices? What potential gains and costs might be expected from an acceleration of evolutionary changes resulting from the pandemic?*



As we entered the pandemic, the important role that community depository institutions (CDIs) play in their communities was only magnified. Like many small businesses, CDIs worked hard to ensure that their customers maintained access to services, while keeping customers and employees safe and healthy. The need was magnified by the importance of financial services to customers' lives, as well as the important role that banks played in the delivery of government stimulus to both consumers and small businesses through Economic Impact Payments and the Paycheck Protection Program.

Initiatives undertaken by CDIs to remain connected to customers were both physical and digital. Many of the physical accommodations, such as installing Plexiglas or modifying drive-throughs, were deemed to be temporary measures. The Council believes that the digital adoption that was accelerated by the pandemic is likely to have long-lasting effects on how CDIs connect with their customers.

Council members noted that although they had been investing in new technologies over the past few years, the pandemic was a catalyst that promoted customer adoption. Investments in digital tools have brought many of the transactional services that customers used to do in branches into their customers' pockets. In many cases, customers did not appreciate the digital services that their CDIs already offered but that they had never fully utilized. Many CDIs also accelerated their investments in digitization, moving their two-year plans up to the next six months. Given this rapid adoption of technology, many CDIs are evaluating the nature of their branch structure, now that customers can access most services digitally.

Many Council members are pleased with how their investments in new technology have performed and are optimistic about the digital future of CDIs. One Council member outlined how an investment in a loan platform was quickly adapted to offer PPP loans ahead of larger competitors. Council members noted that there is concern about how to maintain the same level of personal relationship that sets CDIs apart as consumer interactions become increasingly digital.

The adoption of digital technology extended to employees as well, as CDIs made technology investments that allowed employees to remain connected and productive from home. This presented challenges, especially in rural areas where broadband access may be limited.

The pandemic also put a focus on the importance of access to financial services. Many CDIs noted initiatives to bring unbanked families into the institution to ensure that they have access to critical financial services.

**5. Examination Practices:** *What are the Council's views on the effectiveness of regulatory and supervisory adjustments and accommodations enacted to address problems and concerns resulting from the pandemic and that include:*

- a. *adjustments in safety and soundness guidelines, and requirements by the banking agencies and NCUA to add flexibility for forbearance, loan modifications, and TDRs;*

Council members were appreciative of the overall guidance the agencies have provided and noted that banks are in a much better position to work with their borrowers. However, significant concerns exist going forward as deferral periods wind down and

there seems to be no end to the pandemic in sight—which makes potential credit problems seem inevitable. The big question is what will happen in “round 2”. Questions raised by Council members include:

- Will decisions made in “round 1” – or consistent with “round 1” – be criticized in light of the “round 2” environment? So far, things are fine.
- How many customers that are coming off their 6-month deferral periods will have problems?
- Additionally, how will examiners determine what is “permanent” versus “temporary” in credit conditions? Will the analysis be different as the pandemic persists in 2021, and what will determine whether something is “permanent” in the longer run?

Council members feel that TDR rules and expectations have been relatively clear. However, there is less clarity on issues like appraisal requirements and underwriting. For example:

- Appraised values based on net operating incomes (NOIs) will take a big hit and will be questionable – flexibility is definitely needed.
- When will new appraisals be needed (or when can they be omitted), especially if further modification is needed?
- How will cash flows be analyzed and how this will impact debt covenants?
- CDIs are unclear whether to add or disregard PPP loan exits.
- Council members also have concern going forward on the overall relationship of FASB’s GAAP and the regulatory agencies’ treatment when addressing TDRs.

Lastly, Council members reported some disconnect between the Washington message and an examination team approach, but this does not appear to be a widespread problem.

- b. *the challenges of “off-site” examinations and how the agencies might enhance/adapt the “off-site” examination process to address unique circumstances of community banks;*

The consensus feedback of Council members is that the off-site examination process has been a positive experience, and bankers were satisfied with examiner responsiveness and flexibility during the process. While examinations generally went smoothly, bankers mentioned difficulties uploading information using the standard agency electronic protocols, especially loan documentation, and they had a concern with data privacy. Smaller banks that could not use electronic submissions spent significant time preparing documents for the examiners. In addition, examinations took longer to finish than previous on-site examinations, as examiners asked more follow-up questions on information provided, and examiners did not always communicate well with each other. Lastly, Council members indicated concerns related to examiners not being able to learn the bank culture as well while they are off-site, that new examiners may not learn bank processes as quickly during off-site examinations versus on-site examinations, and that face-to-face communication is helpful in discussing examination processes and findings.

- c. *for those institutions that have received an examination since the COVID-19 pandemic emergency was announced, the extent to which examiners applied the principles in the Interagency Examiner Guidance for Assessing Safety and Soundness Considering the Effect of the COVID-19 Pandemic on Institutions (June 2020). Were appropriate accommodations made for the sake of the health of bank staff and the examiners?*

Response combined with that of 5b above.

- d. *actions to permit more timely and flexible responses from mortgage lenders and servicers to address the needs of mortgage borrowers under duress;*

Council members provided little feedback, other than what was reported in a. above. They did note that examiners look at portfolio lenders more rigorously than secondary market lenders, or that examiners look more closely at the “portfolio” portion of the business. The regulators appear to defer oversight of secondary market lenders to Fannie Mae and Freddie Mac. Despite the supervisory focus, portfolio issues have not significantly surfaced.

Council members believe a coordinated effort is needed going forward between the regulators, legislators, and the industry, with fairness and uniformity being the top concerns.

Council members stated that they appreciate the flexibilities provided to mortgage lenders and loan servicers to navigate pandemic difficulties. The flexibility was beneficial, but it could have been more timely. Council members engage in three sectors of the market: portfolio lending, secondary market lending, and correspondent lending.

Council members report that federal regulators only review the portfolio loans. Most indicated they did not see a need for additional flexibility at this time, although it is relatively early in the process to see the true impact on consumers. They expressed particular appreciation for Regulation X servicing flexibility provided by the Consumer Financial Protection Bureau (CFPB) for post-forbearance accommodations. Council members did note the need for coordinated efforts between the Fannie Mae, Freddie Mac and Federal Housing Finance Agency guidance, regulatory statements, and CARES Act legislation. If well-coordinated, this would provide greater fairness in the treatment of all borrowers seeking forbearance. Council members indicated that the sheer volume of forbearances provided to consumers by loan servicers has led to increases in CFPB servicer complaints regarding timeliness of servicer response.

- e. *Treasury/IRS adjustments necessary to facilitate accommodations between community depository institutions and their customers<sup>1</sup>; and*

Additional guidance from the IRS/Treasury on the tax treatment of selected items would be beneficial to CDIs and their customers. Specifically, uncertainty with respect to the tax treatment and related timing of qualified costs on PPP loans appears to have

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<sup>1</sup> See e.g., issues ##1-3 in the linked letter from the ABA (<https://www.aba.com/advocacy/policy-analysis/aba-recommendations-for-2020-2021-irs-treasury-priority-guidance-plan>).

had an impact on the timing of forgiveness applications and ultimately, the cash flow of borrowers. In addition, there are outstanding issues associated with the treatment of deferred and/or capitalized interest on loans in this economic environment. These issues will likely continue to grow in importance.

f. *Other actions Council members wish to comment on.*

Members suggested that the PPP's streamlined forgiveness program should extend to loans amounts up to \$150,000. The program should also provide simplified guidance, be more flexible for borrowers with larger loans, and generally be less burdensome. Bankers are also concerned with issues related to fair lending and disparities that pandemic responses may be creating. The Council supports the continuing effort to reform the Community Reinvestment Act regulations, which have become antiquated at best and are selectively enforced. (see detailed discussion below).

**6. Federal Reserve and Other Government Pandemic Support:** *What are the Council's views on the efficacy and continuing utility of various programs mandated or envisioned under the CARES Act, including liquidity facilities, targeted lending programs that have grant elements (PPP in particular), and the Main Street Lending Program? Please also comment on the impact of decisions to have Fannie Mae, Freddie Mac, and Ginnie Mae assume certain mortgage servicer obligations for borrowers in forbearance.*

Council members focused on the PPP and the Main Street Lending Program (MSLP). With respect to the PPP, Council members generally believe the program was helpful, particularly since it came early in the COVID-19 pandemic. Also helpful was the Federal Reserve's PPP Liquidity Facility (PPPLF). Initially, this facility appeared beneficial as a source of liquidity for funding additional PPP loans, but as the crisis unfolded, depository institutions in most Districts found that they had unexpected liquidity from a large volume of customer deposits. The main benefit of PPPLF participation is now relief from regulatory capital requirements that would otherwise be triggered by the volume of PPP loans and other balance-sheet growth.

In the early days of PPP, the workload on community depository institutions in standing up the program and processing applications was very heavy. Council members noted that, for some very small community depository institutions, staff resources were insufficient to support participation in the program, and in some cases they referred customers to other lenders. Currently, as the loan forgiveness process ramps up, staffing and workload concerns are reemerging. Council members believe it would be highly beneficial if a streamlined forgiveness process were available for loan amounts up to \$150,000. Council members also noted that, if a "PPP 2.0" is established, they anticipate that it will be more narrowly targeted, and community depository institutions will have to weigh the time, staff requirements, and potential liability involved if lenders are responsible for determining borrowers' eligibility.

The other Federal Reserve program of particular interest and concern is the MSLP. Most Districts reported relatively low interest in MSLP participation, for a number of reasons. Many community depository institutions believe that the program's overall complexity (documentation, required terms, communication process with certain Federal Reserve

Banks) discourages lender participation. MSLP complexity alone meant a slow start to MSLP when staff resources were already preoccupied with PPP loans, and to some extent, the PPP forgiveness process has the same result. The Federal Reserve has provided extensive requirements for loan documentation, and the adaptations of lenders' document production systems has often proven complex and time-consuming. The program portal functionality often makes it difficult to upload required information, especially when information packages are not yet complete. Many institutions also believe that they are not adequately compensated given the risks (retained credit exposure, sharing collateral with the SPV) and the administrative effort required. The risks and administrative burdens incurred are insufficiently covered by the MSLP credits' expected returns.

Council members also note that MSLP terms are unattractive to many borrowers that would qualify, and those terms also exclude many borrowers because they cannot meet one or more program terms. Borrowers who had reasonable 2019 financial results are often able to obtain financing without using the program, and lenders are often able and willing to extend credit to them outside the program, particularly considering the risk/return disincentives noted above. Both lenders and borrowers have been reluctant to commit to the program's heavy debt-service/amortization schedule, especially considering the continuing economic uncertainties resulting from the COVID-19 pandemic. For borrowers that can prudently take on debt, lenders are often willing to retain the entire exposure.

In general, Council members see the MSLP as designed to address a depository institution liquidity shortage that so far has not developed. Given the program's economic disadvantages and its limited appeal to borrowers who can qualify, the Council anticipates that participation is likely to remain modest. In addition, the program's expected sunset at year-end 2020, without indications of an extension, means that the application pipeline is already beginning to shut down.

7. **Additional Matters:** *Do Council members wish to present any other matters affecting community depository institutions that have emerged from meetings of the Reserve Banks' advisory councils?*

**Non-Traditional Bank Charters and Payment System Access:** The state of Wyoming recently issued two Special Purpose Depository Financial Institution (SPDI) bank charters to cryptocurrency business entities. These state-chartered banks will hold 100% reserves against deposits, eliminating the need for FDIC insurance and oversight. These banks are also prohibited from making loans with any funds on deposit. One of the "banks" is affiliated with a cryptocurrency exchange, and the other will be issuing its own digital currency. The Office of the Comptroller of the Currency (OCC) has accepted an application from a large retail mortgage lender to receive a standard national bank charter. This entity will make loans and process payments but will not accept deposits, so it will not be subject to FDIC oversight or Community Reinvestment Act (CRA) requirements. This application is pending at the OCC.

These non-traditional banks share one common traditional desire; to have direct access to a master account at the Federal Reserve. The Council is concerned about apparent uneven levels of oversight for these entities and the increased risks they may pose. The Council recommends that the Federal Reserve be cautious in its approach to allowing non-traditional

banks direct access in the payment system. Regulatory arbitrage resulting from differing requirements should not be allowed to drive entry or provide a shortcut into the payment system. The payment system would benefit from a public and transparent process to determine a safe and secure threshold that applicants must meet to be granted access.

**CRA and Addressing Economic Inequality:** Council members noted that the economic impacts of the pandemic and other crises are likely to change the markets served and products offered by many banks. One result of such changes will be potential impacts to banks' CRA evaluations. It will be important for regulators to support and recognize banks' efforts to expand financial inclusion. When considering how to make CRA evaluations more objective, regulators should be careful not to inadvertently discourage the provision of high-impact banking services that have a low-dollar value (e.g., safe and affordable deposit products, small dollar loans, and micro small business loans) that promote financial inclusion and wealth-building. While banks are still analyzing the Federal Reserve Board's Advance Notice of Proposed Rulemaking, Council members are pleased that it seeks a more objective system of performance measurement designed to avoid encouraging high-dollar transactions at the expense of smaller, high-touch banking products and services.

**GSE Adverse Market Fee:** Council members expressed concern over the 50-basis-point fee on refinance loans scheduled to go into effect on December 1 for loans purchased by Fannie Mae and Freddie Mac. While CDIs have incorporated the fee into their pricing, some Council members noted that the imposition of the fee during a pandemic runs counter to actions taken by the Federal Reserve and by other agencies that were intended to help put impacted borrowers in a better financial situation. Moreover, the fee could contribute to increasing economic inequality by potentially putting refinancing out of reach for some marginal borrowers.