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$2.2 Trillion CARES Act Provides Opportunity for Community Banks

April 2, 2020. Revised on April 7, 2020
Hinshaw Alert

The $2.2 trillion Coronavirus Aid, Relief, and Economic Security Act (CARES Act) was enacted late last week. Designed to provide emergency economic assistance to businesses, families, and individuals, the CARES Act also recognizes the important role that community banks play in the U.S. economy and includes several provisions which will allow community banks to help facilitate the badly needed economic recovery, including the following measures:

- Providing temporary relief from troubled debt restructurings (TDRs);
- Reducing on a temporary basis the Community Bank Leverage Ratio (CBLR);
- Delaying the implementation of the current expected credit losses methodology for estimating allowances for credit losses (CECL);
- Authorizing the Office of the Comptroller of the Currency (OCC) to remove limits on national bank lending limits for nonbank financial firms;
- Authorizing the Federal Deposit Insurance Corp. (FDIC) to revive the Bank Debt Guarantee Program (BDGP); and
- Creating the Small Business Administration (SBA) Paycheck Protection Program (PPP), which will provide banks with the opportunity to serve as lenders to SBA borrowers.

We review these measures in detail below.

Troubled Debt Restructurings (TDRs)

Last month, the federal banking agencies (the "Agencies") issued guidance encouraging banks to work with borrowers and offer payment accommodations to borrowers affected by the COVID-19 crisis. The guidance allows banks to permit borrowers to defer or skip some loan payments or extend the payment due date on a loan.

In conjunction with this guidance, the Agencies indicated that they would not automatically require the banks that modified loans due to COVID-19 to treat such loans as TDRs. A loan that was current when the modification was made would not be treated as a TDR if the modification was made in good faith and in response to the COVID-19 crisis. Although this guidance provides some relief to banks, not all loans modified due to the COVID-19 crisis were exempted under

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the guidance from being treated as TDRs.

The CARES Act expands upon the protections from TDR treatment offered by the Agencies. It provides that any loan modifications will not be treated as TDRs under Generally Accepted Accounting Principles (GAAP) as long as:

- The loan was not more than 30 days past due on December 31, 2019;
- The modification relates to or arises out of the COVID-19 crisis; and
- The modification is made between March 31, 2020 and the earlier of (a) 60 days after the end of the COVID-19 crisis or (b) December 31, 2020 (Section 4013 of the CARES Act).

The afforded TDR treatment relief would run for the term of the loan modification. It would apply to interest rate changes, plans that delay principal or interest payments, forbearance agreements, or similar arrangements. It would not apply to any modifications not related to the COVID-19 crisis.

The Agencies will defer to the bank with respect to treatment of the modified loan, although the bank should keep detailed records of the reasons for modifying the loan.

Community Bank Leverage Ratio (CBLR)

On September 17, 2019, the Agencies issued a new rule to provide for a simplified measure of capital adequacy for certain community banking organizations. The rule took effect on January 1, 2020 and provided that most banks and bank holding companies with assets of less than $10 billion that have a CBLR of greater than 9% would be eligible to use the CBLR framework. We discussed this rule in a Hinshaw client alert.

The CARES Act temporarily reduces the CBLR to 8% until the earlier of December 31, 2020, or 60 days after the end of the COVID-19 crisis. A community bank that falls below this temporary CBLR will have a reasonable grace period (two quarters) to get back into compliance. During this grace period, it must maintain a leverage ratio of greater than 7%.

**April 6, 2020 Update*

On April 6th, the Agencies issued two interim rules. The first interim rule adopted the CARES Act provision discussed above.

The second interim rule will come into play when the temporary CARES Act rule expires, providing a transition from this temporary rule to a 9% CBLR requirement.

The second interim rule provides that the CBLR will be 8% for the balance of 2020, increase to 8.5% on January 1, 2021 and then to 9% on January 1, 2022 and thereafter. As a consequence, even if the COVID-19 crisis ends before December 31, 2020, the CBLR will remain at 8% for the balance of 2020 increasing as discussed above.

Under the second interim rule, the two-quarter grace period would remain in place. For the balance of 2020, a banking organization would have two quarters to get back into compliance as long as it maintains a minimum leverage ratio of at least 7%. On January 1, 2021, the minimum leverage ratio requirement increases to 7.5% and to 8% on January 1, 2022.

If a banking organization fails to get back into compliance at the end of the grace period, it will be required to comply immediately with the rule adopted on September 17, 2019 by the Agencies and file the appropriate regulatory reports.

Similarly, a banking organization that falls below the minimum leverage ratio requirement (7% for the balance of 2020, 7.5% for 2021, and 8% after January 1, 2022) will be required to comply immediately with the rule adopted by the Agencies on September 17, 2019 and file the appropriate regulatory reports.

Update End

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Current Expected Credit Losses (CECL)

The Agencies issued an interim final rule on March 27, 2020 allowing banks that were required to adopt the CECL methodology on January 1, 2020, to delay the estimated impact on cumulative regulatory capital for up to two additional years. The agencies provided a three-year transition period commencing after 2022 to eliminate by phasing out the capital benefit during the two-year delay mentioned above.

Under the CARES Act (Section 4014), financial institutions are excused from complying with the current CECL until December 31, 2020 or 60 days after the end of the COVID-19 crisis, whichever comes earlier.

National Bank Lending Limits

The OCC has been authorized to exempt any transaction or series of transactions from the national bank lending limits for loans to nonbank financial companies (Section 4011 of the CARES Act). This authorization will expire on December 31, 2020, or 60 days after the end of the COVID-19 crisis, whichever comes earlier.

State Bank Lending Limits

Many states have enacted wild card provisions in their laws and regulations that govern state banks. These provisions may be used by state bank regulators to adopt the same lending limits that the OCC adopts, allowing state banks to use such limits when making loans to nonbank financial companies.

Bank Debt Guarantee Program (BDGP)

The FDIC has been authorized to recreate the liquidity guarantee program that was in place during the recession until December 31, 2010.

The recreated BDGP allows the FDIC to guarantee bank and bank holding company debt and all noninterest bearing transaction accounts that exceed the $250,000 FDIC insurance limit (Section 4008 of the CARES Act). Any guarantees must expire by December 31, 2020.

Paycheck Protection Program (PPP)

The CARES Act establishes the PPP, which allows the SBA to guarantee 100 percent of paycheck protection loans. These loans may be used by eligible borrowers to pay payroll costs, rent, health benefits, utilities, interest on mortgage payments, state and local taxes assessed on compensation, and other related expenses.

The program is generally limited to employers with fewer than 500 employees. Businesses in certain industries may have more than 500 employees if they meet the SBA's size standards for those industries.

Applications can be filed starting on April 3, 2020 by small businesses and sole proprietors. Independent contractors and self-employed can submit their applications starting on April 10, 2020. Applications must be submitted by June 30, 2020.

According to the latest terms proposed for these loans, the loan term will be two years and interest rates will be fixed at .50 percent. The loans will be unsecured and no personal guarantees will be required. Loans can be up to 2.5 months of the employer's average monthly payroll costs with a $10 million cap.

There is a substantial demand for these loans, which will allow SBA approved lenders to expand their loan portfolios.

A more detailed discussion of PPP may be found in this Hinshaw client alert.

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