COVID-19 and the Banking Industry: Risks and Policy Responses

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SUMMARY

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The Coronavirus Disease 2019 (COVID-19) pandemic has caused widespread economic disruption. Millions of businesses were forced to shut down and unemployment soared. The weakened economic conditions are likely to have implications for the financial system, including for banks and the banking industry. Many bank assets are loans to households and businesses, and banks rely on the inflow of repayments on those loans to make profits and meet their obligations to depositors and creditors. If repayments suddenly decline, banks can become distressed and potentially fail. Bank failures can be especially disruptive to the economy because they remove an important credit source for communities, and the financial system can become unstable if failures are widespread.

Banks can absorb unanticipated losses on loans, to a point, by writing down the value of the capital. Thus, two key factors in how well banks weather the adverse economic effects of COVID-19 are (1) how concentrated their assets are in loans to households and businesses, and (2) how much capital they hold to absorb losses. Bank data reported as of December 31, 2019, suggest the industry as a whole is relatively well-positioned, compared with recent history, to endure losses on household and business loans. In general, banks hold high levels of capital, largely due to changes in bank regulation and behavior made in response to the 2007-2009 financial crisis. However, certain segments of the industry, such as banks holding high concentrations of household loans, business loans, or both, are more exposed to losses and have less capital relative to those exposures than the industry as a whole. For example, household and business loans make up more than 70% of total assets for 535 banks (roughly, about 1 in 10 banks). These banks, on average, have less capital buffer relative to the size of those loans than most banks. By one metric, 87 banks are in danger of becoming seriously distressed.

Policymakers have recognized and responded to the potential economic ramifications of the pandemic. The federal prudential bank regulators—the Federal Reserve, the Office of the Comptroller of the Currency, and the Federal Deposit Insurance Corporation—initially responded using existing authorities. These regulatory measures, which included issuing guidance and rulemaking, can be placed in two broad categories: (1) helping banks work with troubled borrowers and (2) providing regulatory relief. In addition, the Federal Reserve has taken monetary policy and lender of last resort actions that either directly or indirectly help banks.

Congress passed several bills aimed at mitigating the many financial risks of COVID-19—including the Coronavirus Aid, Relief, and Economic Security Act (CARES Act; P.L. 116-136) and the Paycheck Protection Program and Health Care Enhancement Act (P.L. 116-139). This legislation included sections aimed at helping the banking industry withstand the potential financial strain. Various provisions temporarily relaxed certain bank regulations and accounting rules to give banks more leeway to deal with losses resulting from the pandemic and temporarily granted broader authorities to regulators to deal with potential instability in the banking industry.

COVID-19 has caused economic disruptions that pose unprecedented and unpredictable challenges for banks. Although recent regulatory changes aim to reduce the strain the pandemic will put on banks and the banking industry, banks would nevertheless be impacted if expected payments from affected households and businesses were not made. The banking industry was in a relatively sound position at the outset of the pandemic; however, if the pandemic's economic effects prove to be acute and persistent, banks would be under stress. In addition, certain banks that have especially high concentrations in loans susceptible to missed payments due to the pandemic's effects could be vulnerable. Exactly how the effects of the pandemic will impact the banking industry is uncertain, but it is possible that a number of banks may eventually fail.

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Introduction

The Coronavirus Disease 2019 (COVID-19) pandemic has resulted in millions of cases of infection and more than 100,000 deaths in the United States.[1] Shortly after the onset of the pandemic, it became clear there would be widespread economic effects due to illnesses, quarantines, state and local stay-at-home orders, and other business disruptions.[2] By May 2020, about 21.5 million fewer Americans were employed than in February 2020, and the U.S. unemployment rate had risen from 3.5% to 13.3%.[3] One business group projected that 7.5 million small businesses could close permanently.[4] Consequently, many Americans may lose their main income sources.[5] How the economic situation will develop is difficult to project, due in part to uncertainty about how long the pandemic will continue. Even after businesses reopen, many people may choose to continue to curtail nonessential activities for some time to reduce the likelihood that they catch and spread COVID-19.[6]

Congress passed several bills in an effort to, among other goals, at least partly ameliorate the adverse economic effects of the virus. Legislation includes the Coronavirus Aid, Relief, and Economic Security Act (CARES Act; P.L. 116-136) and the Paycheck Protection Program and Health Care Enhancement Act (P.L. 116-139).[7]

The deterioration of economic conditions has implications for the financial system, including for banks and the banking industry.[8] Many bank assets are made up of loans to households and businesses, and banks rely on the inflow of repayments from those loans to make profits and meet their obligations to depositors and creditors. Even though banks take certain measures to protect themselves against losses, if repayments suddenly decline as a result of widespread unemployment and business closures, banks can become distressed and potentially fail.[9] Bank

[1] Centers for Disease Control and Prevention, Coronavirus Disease 2019, "Cases in the U.S.," June 16, 2020, at https://www.cdc.gov/coronavirus/2019-ncov/cases-updates/cases-in-us.html.

For background on Coronavirus Disease 2019 (COVID-19), see CRS In Focus IF11421, *COVID-19: Global Implications and Responses*, by Sara M. Tharakan et al.

[2] For background on the potential economic effects of the coronavirus in the United States, see CRS Insight IN11235, *COVID-19: Potential Economic Effects*, by Marc Labonte.

[3] Federal Reserve Bank of St. Louis, *Economic Data*, "Employment Level, seasonally adjusted," at https://fred.stlouisfed.org/series/CE16OV; and Federal Reserve Bank of St. Louis, *Economic Data*, "Unemplyment rate, seasonally adjusted," at https://fred.stlouisfed.org/series/UNRATE.

[4] Matthew Wagner and Michael Powe, "The Impact of COVID-19 on Small Businesses: Follow-up Survey Report," Main Street America, May 26, 2020, at https://www.mainstreet.org/blogs/national-main-street-center/2020/05/26/the-impact-of-covid-19-on-small-businesses-follow.

[5] For more information on financial industry policy issues during the COVID-19 outbreak for consumers having trouble paying their bills, see CRS Insight IN11244, *COVID-19: The Financial Industry and Consumers Struggling to Pay Bills*, by Cheryl R. Cooper.

[6] Lydia Saad, *Americans Hesitant to Return to Normal in Short Term*, Gallup, April 1, 2020, at https://news.gallup.com/poll/306053/americans-hesitant-return-normal-short-term.aspx.

[7] CRS products on COVID-19 are available at https://www.crs.gov/resources/coronavirus-disease-2019.

[8] In general, this report examines Federal Deposit Insurance Corporation (FDIC)-insured depository institutions, which include commercial banks and savings associations. When the report examines regulations applicable to the parent bank holding companies that own insured depositories, it is noted. Credit unions are similar to banks in a number of ways and may face similar issues and challenges, but they are not the subject of this report.

[9] Certain provisions of the Coronavirus Aid, Relief, and Economic Security Act (CARES Act; P.L. 116-136) and regulator responses taken under existing authorities aim to enable and encourage banks to grant loan forbearances or other loan modifications; this does not undo the fact that payments were missed and banks could bear losses. For more information, see CRS Report R46356, *COVID 19: Consumer Loan Forbearance and Other Relief Options*, coordinated

failures can be especially disruptive to the economy because they remove an important credit source for communities. Widespread failures could create instability in the financial system.

This report examines how the economic ramifications of the coronavirus pandemic could affect banks and the banking industry. It begins by describing how unexpected missed loan payments affect banks' conditions and how missed payments, when they occur in sufficiently large amounts, can lead to bank failures. It then looks at bank balance-sheet data as of December 31, 2019, to assess the exposure of banks to losses from missed payments on different types of loans before the onset of the pandemic.[10] The report also examines how the responses of the federal bank regulators—the Federal Reserve (Fed), the Office of the Comptroller of the Currency (OCC), and the Federal Deposit Insurance Corporation (FDIC)—and legislation passed by Congress could help mitigate the pandemic's impact on banks. The report concludes with a brief outlook for the banking industry.

How COVID-19 Could Threaten Banks

A bank gets income from the repayments with interest it receives on its assets and fees it charges its customers. A bank charges fees on various types of customer transactions, and it earns interest income mainly on two types of assets: loans and investment securities. Banks get funding to make loans and buy securities by accepting deposits, issuing debt (such as bonds), and raising capital (such as by issuing stocks or retaining profits earned over time). Deposits and debt are liabilities that place a degree of inflexible repayment obligations on banks, whereas a bank has a significant degree of freedom to determine dividend payments on stocks or stock repurchases. The flexibility a bank has over how it manages its capital, including write-down of retained earnings, allows a bank to absorb anticipated losses on assets, to a point, without failing.

As a consequence of the COVID-19 pandemic, some banks might face potential losses that could affect their capital levels and possibly lead to failure. Because of the way regulation requires banks to account for losses, there is a delay before missed payments lead to reductions in loan value and eventual capital write-downs and bank failures. In addition, the effects of missed payments during the pandemic may take longer to appear on bank balance sheets. Normally, if there are no payments on a loan for over 90 days, it is considered a *nonperforming loan*, and the banks are required to take an appropriate write-down on the value of the loan. However, Congress and the federal bank regulators have either required or encouraged banks to allow their customers to delay payments on loans issued by the banks (as well as to grant their customers leniency on certain types of fees), and regulators have given the banks a temporary reprieve on taking certain write-downs for certain loans. These measures are covered in the "Bank Regulator Responses" section, below.

In the short term, the effects of the pandemic will likely first be seen on banks' income statements. Banks account for expected losses by making an adjustment on their balance sheets and income through *loss reserves* (see text box). When banks determine that losses on loans will

by Cheryl R. Cooper.

[10] Banks report income and balance-sheet data as of the end of the financial quarter—March 31, June 30, September 30, and December 31. The World Health Organization (WHO) declared the COVID-19 outbreak a pandemic on March 11, 2020, and President Trump declared a state of emergency on March 13. Thus, December 31, 2019, data are presented in the report as reflecting bank industry conditions before the outbreak had significant effects. March 31, 2020, data are available, but they may reflect changing conditions and initial bank responses to the COVID-19 outbreak in the first weeks of pandemic. March 31, 2020, data are briefly referenced but because this report aims to present conditions before the onset of the pandemic, the focus is on December 31, 2019 data.

be greater than previously estimated, they increase their loss reserves and make a necessary reduction to their recorded earnings. Bank industry data as of the end of the first quarter indicate that banks have begun making these adjustments. Industry loss reserves increased almost $73 billion dollars, or about 59%, from the end of the fourth quarter 2019 to the end of the first quarter 2020 (although a portion of that change was the result of certain banks switching to a different accounting standard, called Current Expected Credit Losses, or CECL, described in footnote 14). Meanwhile, quarterly net income fell to $18.5 billion in the first quarter 2020 from $54.9 billion in fourth quarter 2019, a 66% decline.[11]

Loss Reserves

Credit Loss Reserves[12] (or *loss reserves*) potentially indicate the expected size of losses in the aftermath of economic downturns and disruptions, such as the Coronavirus Disease 2019 (COVID-19) pandemic, that policymakers could monitor in upcoming quarters. Loss reserves are a bank balance-sheet item intended to capture future losses that are expected to occur when some portion of borrowers do not repay. Loss reserves provide a cushion against future losses, and the amount of loss reserves is usually determined every quarter. Estimating the uncollectible amounts used to reduce the book value of loans involves a degree of judgment by bank management. To increase the loss reserves on the balance sheet, banks make an adjustment by reducing earnings for the most recent earning period. If current period earnings are not sufficient, then banks reduce retained earnings—which are part of bank capital.

Over the long term, if current economic conditions persist and borrowers are not able to repay their loans, the banks—without additional reprieve from the financial regulators—would need to fully recognize the losses on the loans and write down the value of capital. This scenario will likely take some time to play out, and the full effects and any related bank failures will likely not be known at least for a few more financial quarters. For example, during the 2007-2009 financial crisis, the number of bank failures reached the highest level a couple of years after the height of the crisis, peaking in 2010 with 157 bank failures.[13] However, because the COVID-19-related financial conditions have different causes than the 2007-2009 financial crisis, it is difficult to predict how the current conditions could affect the number of bank failures and in what time frame.

Banks that incur losses but avoid failure might take time to rebuild capital reserves post-COVID-19, as some banks would have to rely on future earnings and recovery of their investment portfolios. Banks can issue additional stock to rebuild capital, but, at times of economic distress, a successful stock offering might be challenging. Thus, the process of rebuilding capital could temporarily dampen future lending.

Bank Loans and Capital Statistics

Losses on bank loans due to COVID-19 could occur through two broad mechanisms: (1) as many people become unemployed, households may miss payments on their mortgages and consumer loans, and (2) as many businesses close, temporarily or perhaps permanently, they may miss

[11] FDIC, "Quarterly Banking Profile," first quarter 2020, at https://www.fdic.gov/bank/analytical/qbp/qbpmenu.html.

[12] *Current Expected Credit Loss (CECL)* is the new standard to determine the allowance for credit losses. As a consequence of the COVID-19 pandemic, Congress passed a temporary delay as part of the CARES Act. The CECL model considers past events, current conditions, and reasonable and supportable forecasts (forward-looking) that are relevant for assessing the collectability of the cash flows owed on the financial asset. CECL is a single measurement objective that is to be applied to all applicable financial assets. Board of Governors of the Federal Reserve System (Federal Reserve), FDIC, National Credit Union Administration (NCUA), Office of the Comptroller of the Currency (OCC), "Joint Statement on the New Accounting Standards on Financial Instruments - Credit Losses," press release, June 17, 2016, pp. 1-2, at https://www.federalreserve.gov/newsevents/pressreleases/bcreg20160617b.htm.

[13] FDIC, *Failed Bank List*, 2020, at https://www.fdic.gov/bank/individual/failed/banklist.html.

payments on business loans. Banks can survive these losses if they have sufficient capital. This section of the report presents statistics on bank capital and exposure to loans to households and businesses, as of December 31, 2019.[14]

This report focuses on household and business loans because of (1) their importance to banks and the economy and (2) the direct and immediate effect of the pandemic on borrower repayment ability. Banks hold other types of loans and assets, such as loans secured by farmland and loans to municipalities, which also might be sources of potential loss as the pandemic's effects unfold. As the economic situation develops, this report may be updated to examine additional coronavirus-related risks to banks.

Capital

Capital gives banks the ability to withstand losses, to a point, without failing and regardless of what asset classes incur losses. The amount of capital banks hold relative to their assets will play a central role in how well they weather the financial effects of the coronavirus. On its own, overall capital illustrates only how large losses can be until capital is completely exhausted, but banks also face regulatory capital requirements, so it is also informative to examine how much capital banks hold over regulatory minimums.

Regulators require banks to hold certain amounts of different categories of capital relative to assets.[15] These requirements are expressed as ratios. Banks that fall below certain levels face a variety of consequences, such as restrictions on dividend payments to shareholders or on asset growth. If a bank's capital problems are not repaired, it can be shut down and resolved by the FDIC. Thus, a bank becomes seriously impaired at the point that it falls below minimums, not when its capital reaches zero.

Banks face numerous different types of capital requirements, some of which involve calculations called risk-weighting and all of which involve some opportunities to make accounting adjustments. For simplicity and brevity, this report uses a proxy capital measurement to estimate how current bank capital compares with minimums: a ratio of *Tier 1 capital*—a regulatory category of capital, which includes common stock, retained earnings, and certain preferred stock—to total assets. This ratio is similar to, but not precisely the same as, two official regulatory ratios: the *Tier 1 leverage ratio* and the *Community Bank Leverage Ratio*.[16] The difference between the simple Tier 1 capital to asset ratio and the Tier 1 leverage ratio is generally

[14] This section analyzes data from the quarterly report on condition and income filed by FDIC-insured depository institutions, known as the "call report." These data do not include information about the parent bank holding companies that may own these depositories.

This report uses December 31, 2020 data to assess the state of the banking industry at the onset of the pandemic. March 31, 2020 (a date several weeks after the onset of the pandemic) data were available at publication, but CRS analysis found indications that banks had started to experience certain pandemic effects and accordingly made initial adjustments to their balance sheets and income accounting by that date. However, the variables of interest presented here to access the banking industry's longer-term health and risk exposure, including household and business loan concentrations and Tier 1 capital levels, had not meaningfully changed in the first quarter.

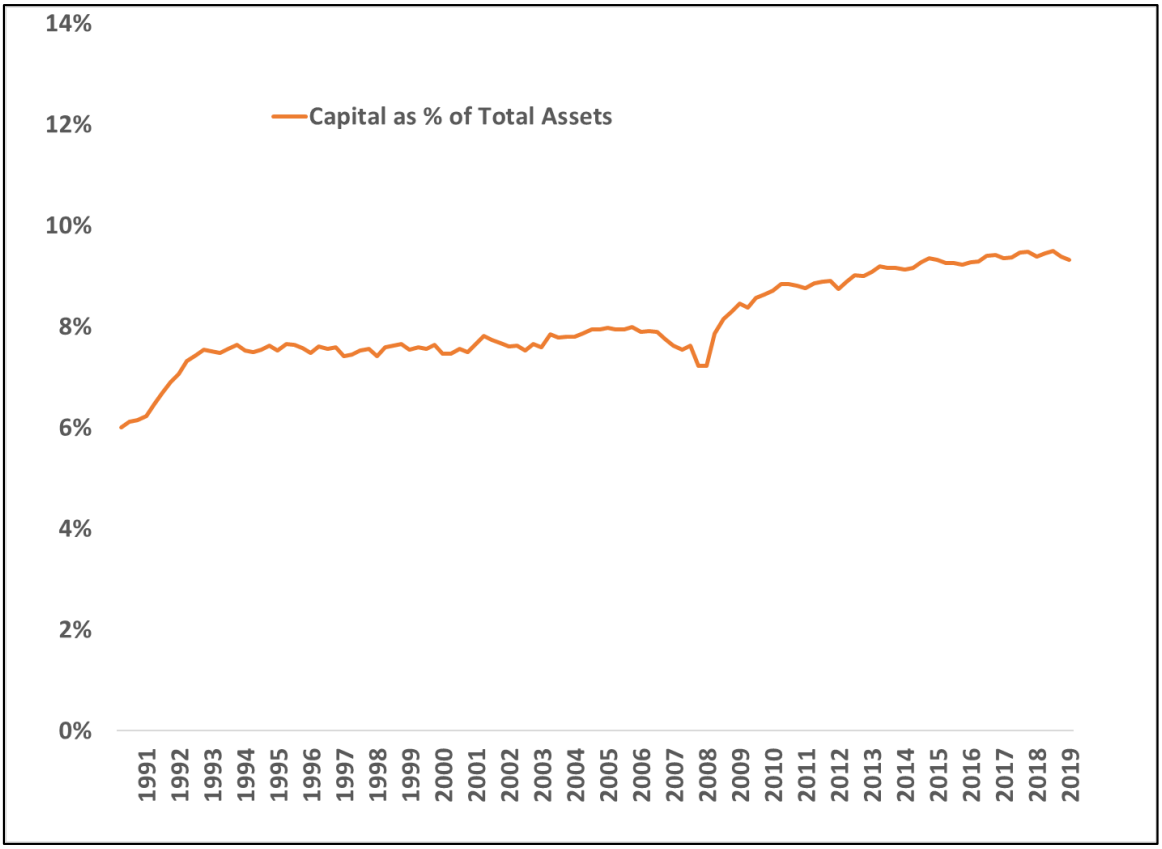
[15] For a more detailed examination of bank capital requirements, see CRS In Focus IF10809, *Introduction to Bank Regulation: Leverage and Capital Ratio Requirements*, by David W. Perkins; and CRS Report R44573, *Overview of the Prudential Regulatory Framework for U.S. Banks: Basel III and the Dodd-Frank Act*, by Darryl E. Getter.

[16] The differences between this report's proxy capital measurement and the two official ratios result mainly from the deductions that banks are allowed to make from their total asset value before calculating the official ratios. In general, the differences are relatively small; however, the bank regulatory ratios are slightly higher than the capital ratio presented in this report.

small, so this report uses the generally applicable regulatory leverage ratio minimum of 4% as a benchmark number when estimating how much capital over regulatory minimums banks hold.

As of December 31, 2019, the banking industry held more than $18.6 trillion in total assets and more than $1.7 trillion in capital, an amount equal to about 9.3% of total assets. If 4% of total assets is used to approximate how much capital the industry needs to hold to meet regulatory minimums, the industry must hold a minimum of $746 billion in Tier 1 capital. This means that at the end of 2019, the industry had a buffer of about $991 billion. This level of capitalization is high relative to recent history, as shown in **Figure 1**, and indicates that banks are generally well above regulatory minimum requirements. For example, at the end of 2007, the industry held 7.6% of total assets in capital and had a buffer of about $458 billion. The relatively high level of capitalization in 2019 was largely due to stringent capital requirements implemented by bank regulators in response to the 2007-2009 financial crisis and changes in bank behavior due to lessons learned from that crisis. By this measure, banks had become more resilient (i.e., they can absorb more future losses than in the past) as they face the current downturn.

Figure 1. Bank Capital Levels, 1991-2019



Source: Congressional Research Service (CRS) calculations based on Federal Deposit Insurance Corporation (FDIC), "Quarterly Banking Profile," fourth quarter 2019 data.

The industry-wide numbers are skewed by a small number of extremely large banks. Thus, it is important to examine banks of different sizes to see how different market segments compare with each other in terms of capitalization or exposure to different asset classes. **Table 1** presents average capital levels for banks of different asset sizes. It shows that, on average, smaller banks were better capitalized than large banks.

Table 1. Ratio of Capital to Total Assets, Banks by Asset Size

as of December 31, 2019

	Count	T1 Capital/Total Assets
All Banks	5,227	12.9%
Over $250 bn	10	8.3%
$100-$250 bn	19	9.8%
$10-$100 bn	111	9.9%
$1-$10 bn	659	10.9%
Less than $1 bn	4,428	13.2%

Source: CRS calculations based on Federal Financial Institution Examination Council (FFIEC) bank call report data for December 31, 2019.

Loans to Households

A significant portion of a typical bank's assets consists of loans to households, which households use to purchase houses, cars, and other consumer goods. This report examines loans in two broad categories:

- loans secured by a home, such as mortgages and home equity lines of credit (*home loans*); and
- loans used to make consumer purchases (*consumer loans*). These can be secured (e.g., auto loans) or unsecured (e.g., credit cards).

Home loans and consumer loans can be pooled into groups and sold to investors or other banks though a process called *securitization*. Many banks own a significant amount of mortgage-backed securities (MBS), almost all of which are backed directly or indirectly by the federal government through government-sponsored enterprises, such as Fannie Mae or Freddie Mac. Arguably, banks are also exposed to losses on these MBS. However, due to the government backing, they are not exposed to default risk, so are not covered in this report.[17]

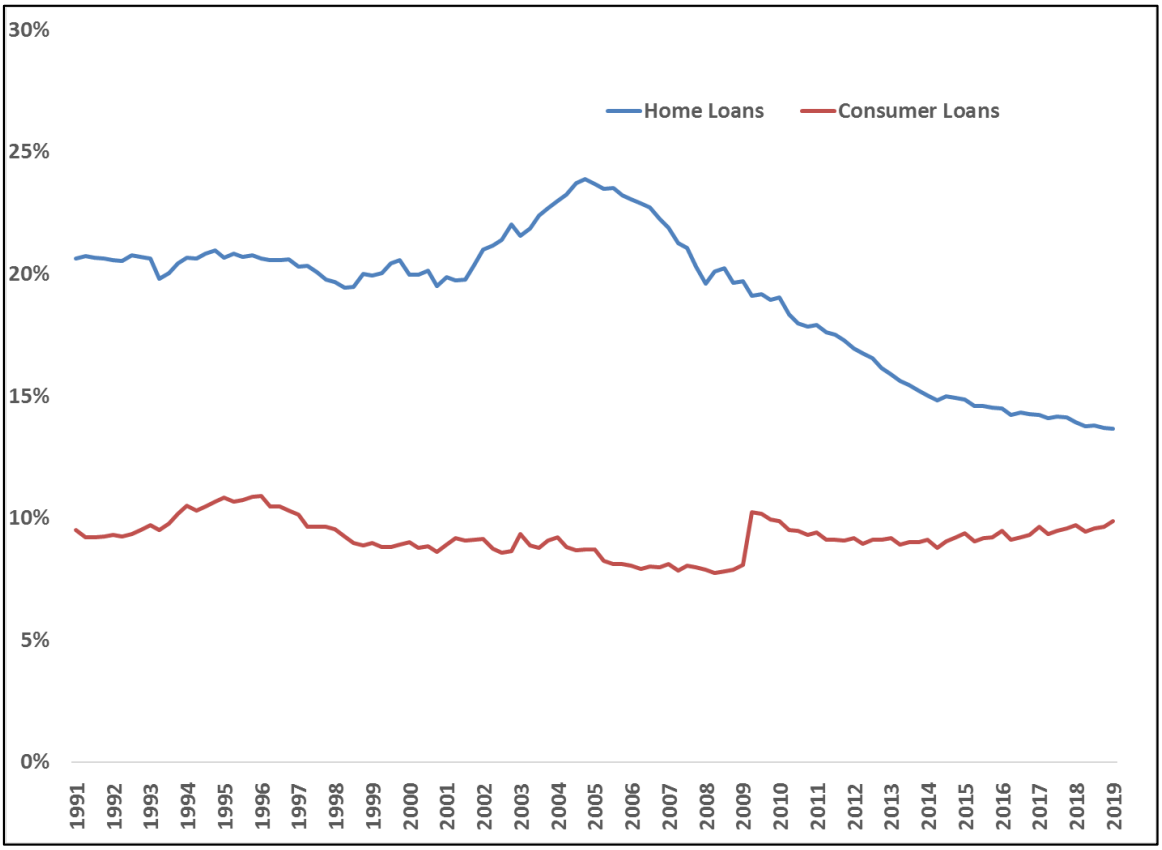
U.S. banks hold more than $2.5 trillion in home loans and more than $1.8 trillion in consumer loans, equaling 13.6% and 9.9% of total assets, respectively (see **Figure 2**).[18] Compared with recent history, these percentages represent a relatively low exposure to home loans and a typical exposure to consumer loans. Along with the relatively high capitalization level discussed in the "Capital" section, these conditions suggest the banking industry is comparatively well-positioned to withstand losses on household debt.

[17] For more information on the federal government's role in the housing finance system, see CRS Report R42995, *An Overview of the Housing Finance System in the United States*, by N. Eric Weiss and Katie Jones.

[18] FDIC, "Quarterly Banking Profile," fourth quarter 2019, at https://www.fdic.gov/bank/analytical/qbp/.

Figure 2. Home Loans and Consumer Loans, 1991-2019

as percent of total assets



Sources: CRS calculations based on FDIC, "Quarterly Banking Profile," fourth quarter 2019 data.

To illustrate how missed payments on home and consumer loans can put banks under stress, **Figure 3** presents these loans' *noncurrent rates* (the percentage of loans for which payment is at least 30 days past due) between 1991 and 2019. During and after the 2007-2009 financial crisis, the noncurrent rates on household loans greatly increased:

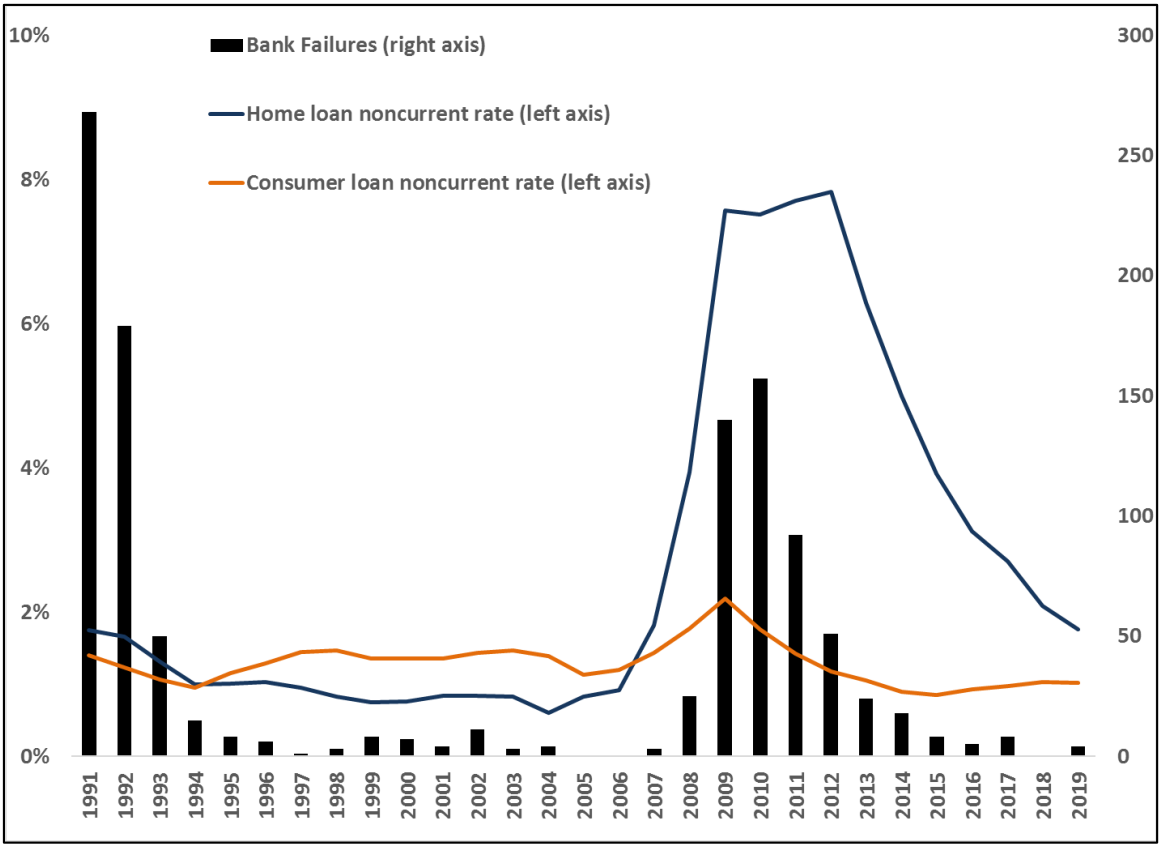
- Home loan noncurrent rates increased from 0.9% in 2006 to 7.8% in 2012. The noncurrent rate at the end of 2019 was 1.8%.
- Consumer loan noncurrent rates increased from 1.0% in 2006 to 2.2% in 2009. The noncurrent rate at the end of 2019 was 1.0%.[19]

Subsequent to the dramatic rise in noncurrent rates, bank failures rose from 0 in 2006 to a peak of 157 in 2010. Between 2008 and 2014, there were 507 bank failures.[20] Defaults on household debt were not solely responsible for these failures. Banks fail for numerous reasons. For example, the high number of failures in the early 1990s were largely the result of the savings and loan crisis, which occurred for numerous reasons (including high and volatile interest rates and adverse regional economic conditions in the 1980s). Nevertheless, the correlation is illustrative of the stress placed on banks by missed household payments.

[19] FDIC, "Quarterly Banking Profile," fourth quarter 2019.

[20] FDIC, "Bank Failures In Brief – Summary 2001 through 2020," at https://www.fdic.gov/bank/historical/bank/.

Figure 3. Household Debt Noncurrent Rates and Bank Failures, 1991-2019



Sources: FDIC "Quarterly Banking Profile," fourth quarter 2019; and FDIC, "Bank Failures In Brief."

Note: All rate and failure numbers are year-end.

Table 2 groups banks based on asset size. In general, smaller banks are more exposed to home loans than large banks, but smaller banks are less exposed to consumer loans and are better capitalized. As of December 31, 2019, the combined home and consumer exposure result in an exposure to household debt that is generally similar across size groups (i.e., roughly 20% to 25%).[21]

Table 2. Average Household Loan Concentrations and Capital, By Asset Size

	Count	Home Loans/ Total Assets	Consumer Loans/ Total Assets	Total HH Loans/ Total Assets	T1 Capital/ Total Assets
All Banks	5,227	19.4%	3.4%	22.8%	12.9%
Over $250 bn	10	11.1%	10.4%	21.5%	8.3%
$100-$250 bn	19	11.6%	18.2%	29.8%	9.8%
$10-$100 bn	111	17.3%	8.4%	25.7%	9.9%
$1-$10 bn	659	18.3%	3.6%	21.9%	10.9%
Less than $1 bn	4,428	19.7%	3.1%	22.8%	13.2%

[21] CRS calculations based on Federal Financial Institution Examination Council (FFIEC) bank call report data for December 31, 2019.

Source: CRS calculations based on FFIEC bank call report data for December 31, 2019.

Notes: HH = Household; T1 = Tier 1. Averages are individual institution means, not weighted by asset size.

Banks differ across business models as well. Whereas some banks choose not to concentrate in any one asset type, other banks choose to specialize to serve a particular market or credit need. For example, a typical bank might have 20% to 25% of assets as household debt, but another, more specialized bank may have twice that exposure or more. As **Table 3** shows, 340 banks have concentrations of between 40% and 50%, and 383 banks have over 50%. These banks are, on average, smaller banks. The 40% to 50% group holds less capital than average, although they still have a high ratio compared with large banks presented above. The over 50% group holds a high level of capital, but some have exposures well above the 50% threshold, as evidenced by the average concentration of 62.5%.

Table 3. Average Bank Size and Capital, By Household Loan Concentration

dollar amounts in millions

Household Loans/ Total Assets	Count	Total Assets	Household Loans/ Total Assets	T1 Capital/ Total Assets
<40%	4,504	$3,788	17.8%	12.9%
40-50%	340	$1,844	44.7%	12.1%
>50%	383	$2,526	62.5%	13.4%

Source: CRS calculations based on FFIEC bank call report data for December 31, 2019.

Note: Averages are individual institution means, not weighted by asset size.

Loans to Businesses

A significant portion of a typical bank's assets consists of loans to businesses, which individuals or companies use to start or expand an enterprise, purchase commercial real estate or equipment, or pay wages to support ongoing operations. Business loans can be divided into two broad categories:

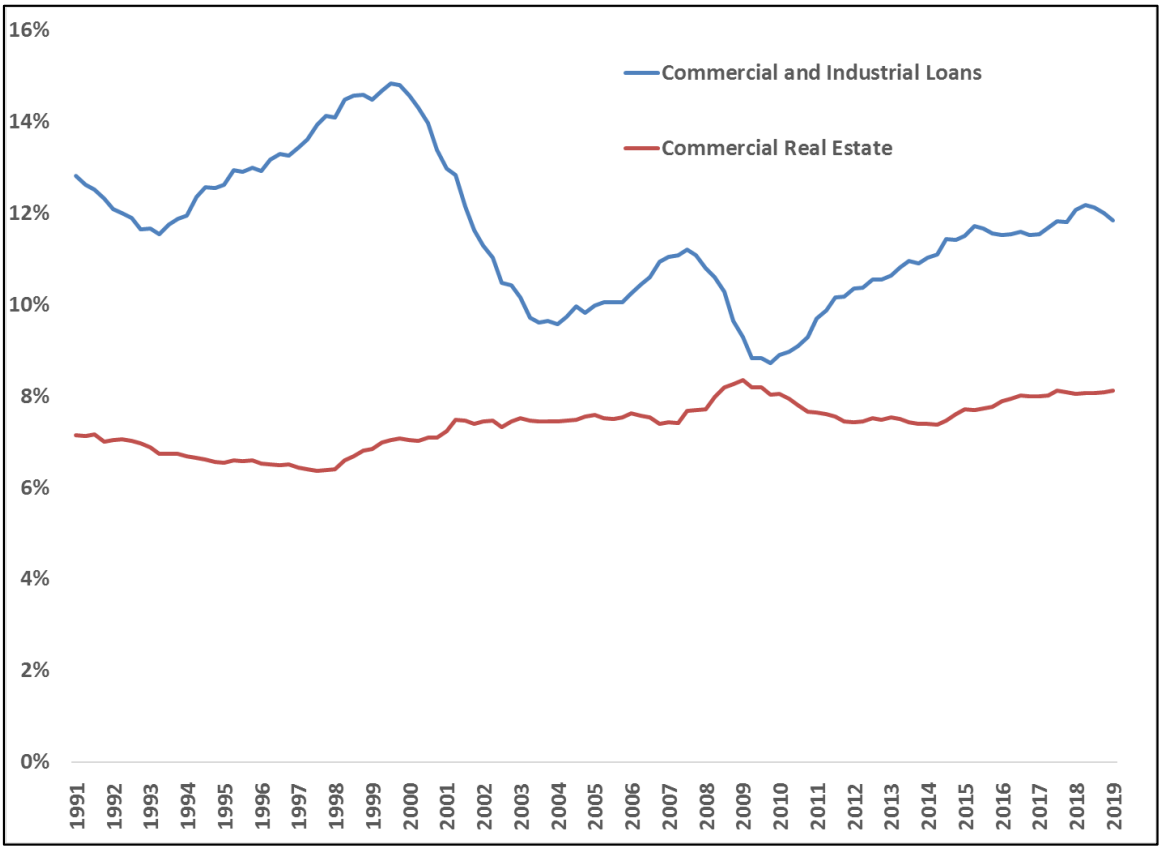
- Commercial real estate (CRE) loans are secured by the land and building in which the business operates, such as a small-town shop or restaurant, a commercial office park, a factory, or a skyscraper. These may be owner occupied (the owner operates the business) or nonowner occupied (the business pays rent to the owner).
- Commercial and industrial (C&I) loans are unsecured or secured by collateral other than real estate, such as equipment.

In all these cases, loan repayment depends on a sufficient inflow of cash to the underlying businesses.

U.S. banks hold more than $1.9 trillion in C&I loans and more than $1.5 trillion in CRE loans, equaling 10.3% and 8.1% of total assets, respectively (see **Figure 4**). The C&I loans-to-total-asset ratio has grown steadily since the post-financial crisis low in 2010; although compared with recent history, the current ratio is about an average C&I exposure. CRE exposures represent a slightly higher-than-average exposure compared with recent history. These conditions suggest the banking industry as a whole may have average to slightly higher-than-average exposure to business loan losses; although with the current high levels of capitalization, they may be well-positioned to withstand losses.

Figure 4. C&I and CRE Loans, 1991-2019

as percent of total assets



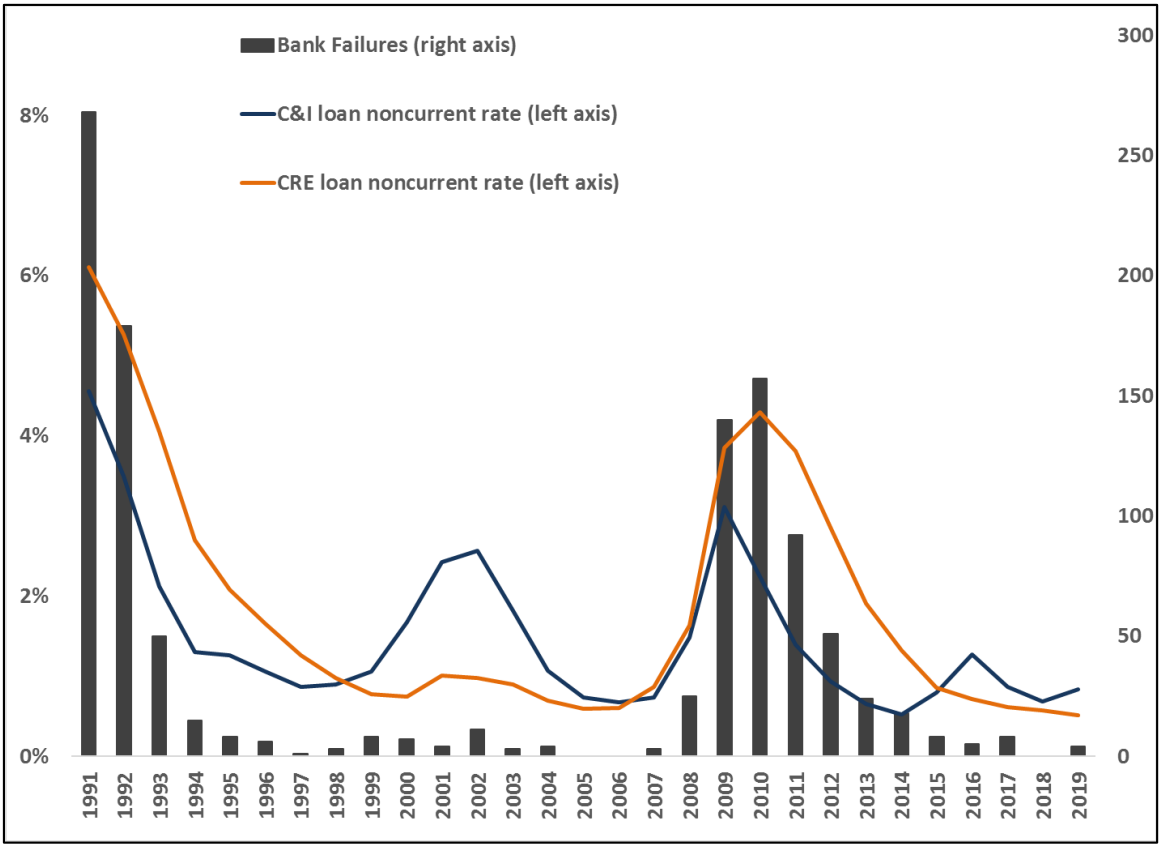
Source: Congressional Research Service (CRS) calculations based on FDIC, "Quarterly Banking Profile," fourth quarter 2019 data.

During and after the 2007-2009 financial crisis, the noncurrent rates for business loans greatly increased, as shown in **Figure 5**:

- C&I loan noncurrent rates increased from 0.7% in 2006 to 3.1% in 2009. The noncurrent rate at the end of 2019 was 0.8%.
- CRE loan noncurrent rates increased from 0.6% in 2006 to 4.3% in 2010. The noncurrent rate at the end of 2019 was 0.5%.

Banks failed for numerous reasons, and defaults on business debt were not solely responsible for the post-crisis failures. The correlation between business loan missed payments and bank failures is nevertheless illustrative.

Figure 5. Business Loan Noncurrent Rates and Bank Failures, 1991-2019



Sources: FDIC, "Quarterly Banking Profile," fourth quarter 2019; and FDIC, "Bank Failures In Brief."

Notes: All rate and failure numbers are year-end.

Banks' business loan concentrations also differ across size groups. **Table 4** groups banks based on asset size. In general, smaller banks—especially banks with $1 billion to $10 billion in assets—are more exposed to business loans than large banks. In terms of the two types of business loans, smaller banks are less exposed to C&I loans but more exposed to CRE loans, and the CRE loan disparity is large enough to result in the greater overall business loan exposure. Whereas the average large bank has less than 20% of assets in business loans, the smaller banks have 23% to 33% in business loans. Smaller banks are better capitalized, so although they may face greater losses on business loans, they may be better situated to absorb the losses.

Table 4. Average Business Loan Concentrations and Capital, by Asset Size

	Count	C&I Loans/ Total Assets	CRE Loans/ Total Assets	Business Loans/ Total Assets	T1 Capital/ Total Assets
All Banks	5,227	8.2%	16.3%	24.5%	12.9%
Over $250 bn	10	10.7%	4.5%	15.1%	8.3%
$100-$250 bn	19	13.9%	4.8%	18.8%	9.8%
$10-$100 bn	111	11.4%	16.6%	28.1%	9.9%
$1-$10 bn	659	10.8%	22.5%	33.3%	10.9%
Less than $1 bn	4,428	7.7%	15.4%	23.1%	13.2%

Source: CRS calculations based on FFIEC bank call report data for December 31, 2019.

Note: Averages are individual institution means, not weighted by asset size.

As **Table 5** shows, 515 banks had business loan concentrations of between 40% to 50%, and 349 banks are over 50%. These banks are smaller than average—particularly the most heavily concentrated group—and hold less capital than banks not concentrated in business loans, but they still have a higher ratio compared with large bank ratios displayed in **Table 4** above.

Table 5. Asset Size and Capital, by Business Loan Concentration

dollar amounts in millions

Business Loans/ Total Assets	Count	Total Assets	Business Loans/ Total Assets	T1 Capital/ Total Assets
<40%	4,363	$3,948	19.4%	13.5%
40-50%	515	$2,094	44.3%	11.1%
>50%	349	$1,009	58.2%	11.8%

Source: CRS calculations based on FFIEC bank call report data for December 31, 2019.

Notes: Averages are individual institution means, not weighted by asset size.

Combined Household and Business Loan Exposures

In total, banks held nearly $8.1 trillion worth of household and business loans, which accounts for over 43% of their total assets. This is slightly less than the 1991-to-2019 average of 45% and well below the two-decade high of 51% reached in 2000.

On average, mid-size banks with assets between $1 billion and $10 billion have the highest concentration in household and business loans, followed closely by $10 billion to $100 billion banks, as shown in **Table 6**. The 10 banks with over $250 billion in assets have the lowest concentration in these loans.

Table 6. Average Combined Loan Concentrations and Capital, by Asset Size

	Count	Household and Business Loans/ Total Assets	Tier 1 Capital/ Total Assets
All Banks	5,227	47.3%	12.9%
Over $250 bn	10	36.7%	8.3%
$100-$250 bn	19	48.6%	9.8%
$10-$100 bn	111	53.8%	9.9%
$1-$10 bn	659	55.3%	10.9%
Less than $1 bn	4,428	45.9%	13.2%

Source: CRS calculations based on FFIEC bank call report data for December 31, 2019.

Note: Averages are individual institution means, not weighted by asset size.

When the household loan and business loan categories are combined, the data indicate that many banks are heavily concentrated and could become vulnerable if the economic effects of the COVID-19 pandemic cause missed payments across both categories—in other words, if the pandemic causes widespread and lasting economic damage. As shown in **Table 7**, there are 535 banks whose assets are made up of more than 70% household and business loans. These banks tend to be smaller than less concentrated banks and are relatively less capitalized.

Table 7. Asset Size and Capital, by Combined Loan Concentration

dollar amounts in millions

Combined Loans/ Total Assets	Count	Total Assets	Combined Loans/ Total Assets	Tier 1 Capital/ Total Assets
<50%	2,644	$4,565	32.1%	15.7%
50-70%	2,048	$2,624	59.4%	11.5%
>70%	535	$2,261	75.8%	11.4%

Source: CRS calculations based on FFIEC bank call report data for December 31, 2019.

Note: Averages are individual institution means, not weighted by asset size.

According to one measure,[22] banks' loss rate on total loans in the two years following the 2007-2009 financial crisis was nearly 6%. An estimate of how many banks could fall below a 4% Tier 1 capital-to-total asset ratio if this loss rate occurs on household and business loans is presented in **Table 8**.

By this metric, 87 banks are in danger of becoming seriously distressed, which some may view as an encouraging number relative to the over 500 banks that failed in the aftermath of the last financial crisis; the number reflects how much better capitalized banks are now relative to then.

Any hypothetical loss rate is bound to involve a degree of uncertainty given the uncertainty involved in the pandemic's economic effects, and a number of caveats should be kept in mind when examining this estimate. As previously discussed, the last crisis had certain key differences from the pandemic-related crisis. In addition, the 6% was an average across all bank loans; some loan categories experienced higher loss rates than others, which will likely be the case following the pandemic. Furthermore, this estimate assumes no losses on other categories of loans, such as farm loans and loans to municipalities. If losses were experienced across a broader class of loans than household and business loans, more banks could fall below the 4% level.

Table 8. Banks Falling Below 4% Tier 1 Capital Given 6% Loss, By Concentration

Combined Loans/ Total Assets	Count	6% Loss > Tier 1 Buffer
<50%	2,640	10
50-70%	2,046	31
>70%	535	46

Source: CRS calculations based on FFIEC bank call report data for December 31, 2019.

Note: Four banks in the less than 50% group and two banks in the 50%-70% group are not included because they are already below 4% level.

Bank Regulator Responses

Bank regulators have taken three general approaches to managing issues stemming from COVID-19:

1. ensuring banks have sufficient means to address operational risks;

[22] This loss rate was calculated by dividing the cumulative net charge-offs (the amount of loans banks recognize as uncollectable minus the amount they recover from those loans) from the fourth quarter of 2008 through the fourth quarter 2010 by average total loans during this period.

2. encouraging consumers to work with customers who are affected by the pandemic; and
3. adjusting regulations and regulatory requirements to ensure financial institutions can continue lending during the pandemic.

Unless otherwise noted, these regulatory changes were joint rulemakings or guidance involving multiple banking regulators. Bank regulators have also issued regulations and guidance to implement provisions of the CARES Act, which are discussed in the "Congressional Response to Help Banks" section. In addition, the Fed has made regulatory changes aimed at addressing bank liquidity, which are discussed in the "Federal Reserve Actions Related to Bank Liquidity" section.

Operational Risk Planning

Regulators' efforts to deal with the potential effects of COVID-19 began in early March 2020, with attempts to ensure that depository institutions were adequately planning for the potential risks. The initial framework for these efforts built upon existing guidance aimed at ensuring banks had sufficient means to address operational risks stemming from an influenza pandemic.[23] The guidance identifies business continuity plans as a key tool to address pandemics and provides a comprehensive framework to ensure the continuation of critical operations.

Pandemic planning is different from other types of business continuity plans in a few ways. For instance, natural disasters and malicious activity are often specific to a particular geographic region or facility (i.e., those occurrences are limited in scope and duration). The effects of a pandemic are more difficult to plan for, as they can occur globally and in multiple waves. The regulators initially set out to ensure that financial institutions had adequate plans to continue operations during a global pandemic, which is the case with COVID-19.

Guidance to Help Troubled Borrowers

Once it was clear that COVID-19 was a global pandemic with far-reaching economic impacts, regulators shifted focus to providing guidance on how to address and serve affected customers.[24]

Ways to Work with Customers

In early March 2020, banking regulators began encouraging financial institutions to work with customers in COVID-19-affected areas.[25] Throughout March, the regulators began clarifying the ways they wanted financial institutions to address consumer concerns and began providing more incentives for doing so. For example, regulators announced that any "prudent efforts to modify terms of existing loans for affected customers would not be subject to supervisory criticism"—in

[23] On March 6, 2020, the FFIEC updated its influenza pandemic guidance to minimize the potentially adverse effects of COVID-19. See FFIEC, "Interagency Statement on Pandemic Planning," March 6, 2020, at https://www.ffiec.gov/press/PDF/FFIEC%20Statement%20on%20Pandemic%20Planning.pdf.

[24] For more on policy options for financial services companies responding to customers affected by COVID-19, see CRS Insight IN11244, *COVID-19: The Financial Industry and Consumers Struggling to Pay Bills*, by Cheryl R. Cooper.

[25] Each of the regulators typically issues its own press release when there are joint agency statements. For example, see OCC, "Agencies Encourage Financial Institutions to Meet Financial Needs of Customers and Members Affected by Coronavirus," press release March 9, 2020, at https://www.occ.gov/news-issuances/news-releases/2020/nr-ia-2020-30.html.

other words, efforts to help customers would not face the type of safety and soundness concerns that might otherwise be raised in bank examinations in normal times.[26]

Some of the ways regulators suggest that institutions help customers include the following:

- Waiving certain fees, such as:
  - Automated teller machine (ATM) fees for customers and non-customers,
  - Overdraft fees,
  - Late payment fees on credit cards and other loans, and
  - Early withdrawal penalties on time deposits;
- Increasing ATM daily cash withdrawal limits;
- Easing restrictions on cashing out-of-state and non-customer checks;
- Increasing credit card limits for creditworthy borrowers;
- Offering payment accommodations, such as allowing borrowers to defer or skip some payments or extending the payment due date, which would avoid delinquencies and negative credit bureau reporting; and
- Working with consumers who are temporarily unable to work due to temporary business closures, slowdowns, or sickness.[27]

Additionally, the federal regulators began encouraging financial institutions to offer small-dollar loans to consumers and businesses affected by COVID-19 to help meet customers' needs due to shortages in cash, unexpected expenses, or income disruptions.[28]

These initiatives reflect the regulators' views that efforts to help customers "serve the long-term interests of communities and the financial system when conducted with appropriate management oversight and are consistent with safe and sound banking practices and applicable laws, including consumer protection laws."[29]

Community Reinvestment Act

Another consequence of the far-reaching economic impact of COVID-19 is its effect on low- and moderate-income (LMI) areas. Building off their guidance to ensure financial institutions are able to continue working with customers, regulators began providing new incentives for institutions to help LMI customers. The Community Reinvestment Act (CRA; P.L. 95-128) was enacted to increase the likelihood that banks would sufficiently address the credit needs of LMI neighborhoods. Because banks may accept deposits from all individuals in a community, the CRA establishes a reciprocal obligation to meet the credit needs, as much as possible, of their

[26] For instance, see FDIC, "Regulatory Relief: Working with Customers Affected by Coronavirus," March 13, 2020, at https://www.fdic.gov/news/news/financial/2020/fil20017.pdf (hereinafter FDIC, "Regulatory Relief: Customers Affected by Coronavirus").

[27] FDIC, "Regulatory Relief: Customers Affected by Coronavirus."

[28] Federal Reserve, Consumer Financial Protection Bureau (CFPB), FDIC, NCUA, and OCC, "Joint Press Release: Federal agencies encourage banks, savings associations and credit unions to offer responsible small-dollar loans to consumers and small businesses affected by COVID-19," press release, March 26, 2020, at https://www.federalreserve.gov/newsevents/pressreleases/bcreg20200326a.htm.

[29] FDIC, "FDIC Statement on Financial Institutions Working with Customers Affected by the Coronavirus and Regulators and Supervisory Assistance," March 13, 2020, at https://www.fdic.gov/news/news/financial/2020/fil20017a.pdf.

communities at large.[30] Banking institutions can often receive CRA credits for meeting customer cash and financial needs during major disasters in adversely affected communities, even in those where the bank does not primarily accept deposits.[31] In March, the Fed, FDIC, and OCC issued a joint statement declaring "that financial institutions will receive CRA consideration for community development activities."[32] These activities include the following:

> Loans, investments or services that support digital access for [LMI] individuals or communities;
>
> Loans, investments or services that support access to health care, particularly for [LMI] individuals or communities;
>
> Economic development activities that sustain small business operations, particularly in [LMI] communities; and
>
> Investment or service activities that support provision of food supplies and services for [LMI] individuals or communities.[33]

Regulatory Relief

Banks are subject to "safety and soundness" regulations, which include capital and liquidity regulatory requirements and examinations and off-site bank monitoring by bank regulators. Similar to how regulators facilitated working with consumers affected by COVID-19 through regulatory flexibility, bank regulators have also made certain adjustments to banking regulation and supervision to ensure that safety and soundness regulations, such as liquidity and capital requirements, do not impede banks' abilities to respond to the credit needs of customers negatively affected by COVID-19. The policy tradeoff is that these changes could negatively affect banks' safety and soundness at a time when banks face the prospect of rising default rates and declining asset values. This section describes regulatory relief provided to bank depositories and bank holding company (BHCs) in cases when the relief is applied to bank-like reporting and liquidity requirements.

Recent changes span numerous different regulatory areas. Ways that regulators have provided regulatory relief include the following: facilitating flexible supervisory requirements and alternative examination schedules; deferring regulatory requirements that social distancing makes difficult; delaying the implementation of new regulations; and changing or relaxing institutional reporting requirements. These changes allow banks with operational challenges to focus on serving customers under limited staffing.

Supervision

The social distancing guidelines resulting from COVID-19 have presented a challenge for normal supervision by regulators to ensure that banks comply with various laws and regulations. One way regulators have adapted to this new order of operations is to help banks manage regulatory

[30] For more on the Community Reinvestment Act (CRA; P.L. 95-128), see CRS Report R43661, *The Effectiveness of the Community Reinvestment Act*, by Darryl E. Getter.

[31] FDIC, *Disaster Relief and the Community Reinvestment Act*, July 2013, at https://www.fdic.gov/consumers/community/aei/regional/2013-07-ct/disasterrelief-cra.pdf.

[32] Federal Reserve, FDIC, and OCC, "Joint Statement on CRA Consideration for Activities in Response to COVID-19," March 19, 2020, at https://www.fdic.gov/news/news/financial/2020/fil20019a.pdf (hereinafter Fed, FDIC, and OCC Joint Statement, March 2020).

[33] Fed, FDIC, and OCC Joint Statement, March 2020.

requirements during this period without the need for on-site examinations. For instance, the Fed announced adjustments to its supervisory activities and priorities in response to the uncertainties created by COVID-19 on March 24.[34] Broadly, the Fed temporarily shifted its focus from examination to monitoring in order to better understand "the challenges and risks that the current environment presents." The Fed announced on June 15, 2020, that it would resume examination activities, though it anticipated it would conduct exams off-site until conditions improved.[35]

Another way regulators have responded is by granting broad flexibility to banks with respect to taking enforcement or supervisory actions against institutions attempting to work with customers through the pandemic. For example, the banking agencies issued a joint statement on April 3, 2020, regarding a "flexible supervisory and enforcement approach during the COVID-19 emergency regarding certain consumer communications required by the mortgage servicing rules."[36] This announcement is intended to help mortgage servicers provide programs to assist struggling consumers affected by the pandemic.

Capital and Liquidity

One of the main ways regulators make sure financial institutions are prepared for negative economic events is by ensuring banks hold ample capital and liquidity during good economic conditions. Then, when adverse conditions occur, banks would have a buffer above the required minimums to absorb losses while being able to continue providing credit to the economy. Normally, banks try to avoid a decline in buffers because it could attract regulatory scrutiny as a sign of distress. In March 2020, bank regulators released a statement encouraging banks to use their capital and liquidity buffers to support continued lending.[37] This guidance reminds banks that the purpose of the buffers is to ensure banks can keep lending during distressed times and encourages banks to continue lending prudently. In addition, to encourage use of banks' buffers, bank regulators issued a rule change on March 20 on how capital is measured to make it easier for banks to comply with capital rules that can place restrictions on a bank's dividend payments and other capital distributions.[38] There also have been changes to large bank capital standards, discussed in the "Regulatory Changes Affecting Large Banks" section, below.[39]

Ownership and Control

On January 30, 2020, the Fed adopted a final rule to revise its regulations related to determinations of whether a company controls another company for purposes of the Bank

[34] Federal Reserve, "Federal Reserve Statement on Supervisory Activities," March 24, 2020, at https://www.federalreserve.gov/newsevents/pressreleases/files/bcreg20200324a1.pdf.

[35] Federal Reserve, "Federal Reserve Board announces it will resume examination activities for all banks, after previously announcing a reduced focus on exam activity in light of the coronavirus response," press release, June 15, 2020, at https://www.federalreserve.gov/newsevents/pressreleases/bcreg20200615a.htm.

[36] CFPB, Federal Reserve, FDIC, NCUA, OCC, and Conference of State Bank Supervisors, "Joint Statement on Supervisory and Enforcement Practices Regarding the Mortgage Servicing Rules in Response to the COVID-19 Emergency and the CARES Act," April 3, 2020, at https://www.fdic.gov/news/news/press/2020/pr20047a.pdf.

[37] Federal Reserve, FDIC, and OCC, "Statement on the Use of Capital and Liquidity Buffers," March 17, 2020, at https://www.fdic.gov/news/news/press/2020/pr20030b.pdf.

[38] OCC, Federal Reserve, and FDIC, "Regulatory Capital Rule: Eligible Retained Income," 85 *Federal Register* 15909-15916, March 20, 2020.

[39] Federal Reserve, FDIC, and OCC, "Regulators temporarily change the supplementary leverage ratio to increase banking organizations' ability to support credit to households and businesses in light of the coronavirus response," press release, May 15, 2020, at https://www.federalreserve.gov/newsevents/pressreleases/bcreg20200515a.htm.

Holding Company Act or the Home Owners' Loan Act.[40] As a result of COVID-19, many companies, including regulated financial institutions, have expressed concerns about the effect of the new control rule on various existing investments and relationships. In response, the Fed delayed (from April 1 to September 30)[41] the implementation of a new framework for what factors determine "control" of a company for the purposes of the Bank Holding Company Act[42] and the Home Owners' Loan Act.[43]

Real Estate Appraisals

Appraisals are normally required to ensure mortgages are backed by sufficient collateral to avoid losses in case of default. Restrictions on nonessential movement and health and safety advisories issued in response to the COVID-19 pandemic, including those relating to social distancing, have complicated the performance and completion of real property appraisals and evaluations needed to comply with federal appraisal regulations.

On April 17, 2020, the OCC, Fed, and FDIC issued an interim final rule aimed at addressing this problem. The interim rule temporarily defers real estate-related appraisals and evaluations under the agencies' interagency appraisal regulations to allow regulated institutions to extend financing to creditworthy households and businesses quickly in the wake of the national emergency declared in connection with COVID-19.[44] Transactions involving acquisition, development, and construction of real estate are excluded from this interim rule. These temporary provisions will expire on December 31, 2020, unless extended by the federal banking agencies.

Regulatory Changes Affecting Large Banks

Under the Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank; P.L. 111-203) and Basel III[45]—an international accord that sets standards for bank regulation—the largest banks face more complex and stringent regulations than other banks.[46] As a result, a number of regulations (or more stringent versions of regulations) apply only to large banks. The Fed has delayed or relaxed a number of these regulations in response to COVID-19. For example, the Fed announced that the modification to the definition of capital, discussed in the "Capital and Liquidity" section, would also be applied to the total loss-absorbing capacity rules applied to the largest U.S. banks and U.S. operations of foreign banks. The rules require those banks to hold certain types and amounts of capital and debt at the holding company level.[47]

According to the Fed, one of the effects of COVID-19 on the banking system has been an increase in the size of bank balance sheets due to customer draws on credit lines and acquisitions of U.S. Treasury securities. As a result, banking organizations have been making substantial deposits in their accounts at Federal Reserve Banks, potentially constraining the institutions'

[40] Federal Reserve, "Control and Divestiture Proceedings," 85 *Federal Register* 12398-12430, March 2, 2020.

[41] Federal Reserve, "Control and Divestiture Proceedings," 85 *Federal Register* 18427-18428, April 2, 2020.

[42] 12 U.S.C. §1841.

[43] 12 U.S.C. §1461.

[44] OCC, Federal Reserve, and FDIC, "Real Estate Appraisals," 85 *Federal Register* 21312-21318, April 17, 2020.

[45] For more information on the Basel III Accords, see CRS Report R44573, *Overview of the Prudential Regulatory Framework for U.S. Banks: Basel III and the Dodd-Frank Act*, by Darryl E. Getter.

[46] For more information, see CRS Report R45711, *Enhanced Prudential Regulation of Large Banks*, by Marc Labonte.

[47] Federal Reserve, "Federal Reserve Board announces technical change to support the U.S. economy and allow banks to continue lending to creditworthy households and businesses," press release, March 23, 2020, at https://www.federalreserve.gov/newsevents/pressreleases/bcreg20200323a.htm.

ability to intermediate funds throughout the financial system and to consumers. In response, the Fed took steps to ease strains in the Treasury market resulting from COVID-19 and to increase banking organizations' ability to provide credit to households and businesses. Specifically, the Fed relaxed the supplementary leverage ratio rule that applies to the largest banking organizations by exempting certain safe assets from the banks' exposure measures.[48] The change to the supplementary leverage ratio is intended to mitigate the risk of an increase in a bank's balance sheet from requiring it to hold more capital.

The Fed also allowed an exception to Wells Fargo's asset cap, imposed in response to Wells Fargo's fake-accounts scandal, to allow the bank to expand its Payroll Protection Program loans.[49]

Ancillary Outcome of the Paycheck Protection Program: Income for Banks

The CARES Act (P.L. 116-136) created the Paycheck Protection Program (PPP) to provide small businesses and self-employed individuals with loans through the Small Business Administration (SBA) 7(a) program so that they may continue to pay employees and replace lost income resulting from Coronavirus Disease 2019 (COVID-19) disruptions. The details of this program are beyond the scope of this report.[50] For more information, see CRS Report R46284, *COVID-19 Relief Assistance to Small Businesses: Issues and Policy Options*, by Robert Jay Dilger, Bruce R. Lindsay, and Sean Lowry.

One aspect of the program pertinent to this report is that businesses and individuals apply for the loans to banks, among other types of lenders, who originate the loans. The rationale for utilizing private loan-making institutions is that they are arguably better positioned, given their usual day-to-day operations and existing customer relationships, to deploy PPP funds more quickly than a government institution.[51] Banks and other lenders can charge fees for originating loans, and thus earn income through their roles in administering the PPP program. This feature potentially makes the PPP a source of income for the banking industry at a time when banks may expect future losses.

PPP loans are guaranteed by the SBA.[52] Provided banks collect required documentation from borrowers, PPP loans expose banks to relatively little risk of loss. Accordingly, the CARES Act mandated that they be given a zero risk-weight for the purposes of determining banks' risk-based capital requirements. In their rulemaking implementing how PPP loans would be treated in regulation, the bank regulators exempted PPP loans from affecting any bank capital requirements.[53] Finally, the Federal Reserve has established the PPP Liquidity Facility, which allows banks to access low-cost liquidity using their PPP loans as collateral. These features could make the PPP attractive to banks.

[48] Federal Reserve, "Temporary Exclusion of U.S. Treasury Securities and Deposits at Federal Reserve Banks From the Supplementary Leverage Ratio," 85 *Federal Register* 20578-20586, April 14, 2020.

[49] Federal Reserve, "Federal Reserve Board announces, due to the extraordinary disruptions from the coronavirus, that it will temporarily and narrowly modify the growth restriction on Wells Fargo so that it can provide additional support to small businesses," press release, April 08, 2020, at https://www.federalreserve.gov/newsevents/pressreleases/enforcement20200408a.htm. For more on the Wells Fargo scandal, see CRS In Focus IF11129, *Wells Fargo—A Timeline of Recent Consumer Protection and Corporate Governance Scandals*, by Cheryl R. Cooper and Raj Gnanarajah.

[50] See Small Business Administration (SBA), "Paycheck Protection Program," at https://www.sba.gov/funding-programs/loans/coronavirus-relief-options/paycheck-protection-program.

[51] Certain lenders specialize in originating SBA-guaranteed loans. See SBA, "100 Most Active SBA 7(a) Lenders," at https://www.sba.gov/article/2020/mar/02/100-most-active-sba-7a-lenders.

[52] SBA, "Business Loan Program Temporary Changes; Paycheck Protection Program," 85 *Federal Register* 20811-20812, April 15, 2020.

[53] Federal Reserve, OCC, and FDIC, "Federal Bank Regulators Issue Interim Final Rule for Paycheck Protection Program Facility," press release, April 9, 2020, at https://www.fdic.gov/news/news/press/2020/pr20050.html.

Reporting Requirements

Another way regulators have provided regulatory relief is by changing or relaxing institutional reporting requirements. For instance, bank regulators granted banks an additional 30 days to file their required quarterly reports on condition and income.[54] The Fed granted a similar grace period to bank holding companies (BHCs) and nonbank BHC subsidiaries with less than $5 billion in assets.[55]

Accounting Standards

Regulators have also allowed institutions to take alternative approaches to accounting for certain COVID-19-related financial impacts. For instance, on March 27, 2020, bank regulators announced that banks could adopt an early change in the accounting methodology for certain derivatives contracts, and certain banks could delay the effect on regulatory capital of a new accounting standard (Current Expected Credit Loss, or CECL) related to estimating future losses.[56] The CECL announcement included an interim final rulemaking issued under the regulators' existing authority that implemented a delay period longer than the one required by the CARES Act, which was enacted the same day as the announcement. The CARES Act mandate and regulator rulemaking relating to CECL is discussed in the "Current Expected Credit Loss (Section 4014)" section of this report.

Federal Reserve Actions Related to Bank Liquidity

In addition to the bank regulatory responses described in the previous section, the Fed has taken actions to increase bank liquidity during the COVID-19 pandemic. These actions—specifically, encouraging banks to borrow from the Fed's discount window and changes to bank reserve requirements—affect banks directly at the depository level and are covered in this section of the report.

The Fed has also taken actions focused primarily on stimulating the economy and creating emergency facilities to help the firms and parts of financial markets harmed by the pandemic. Banks are not the primary target of most of these Fed measures but may benefit incidentally. For example, the Fed has made efforts to ensure there is ample liquidity in the financial system during this period of financial stress. Ample liquidity also promotes the stability of the banking system because of the liquidity mismatch inherent on a bank's balance sheet—a bank tends to hold relatively illiquid assets (e.g., loans) and liquid liabilities (e.g., demand deposits). However, because providing banks with liquidity is not these programs' primary purpose, they are beyond the scope of this report.[57]

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[54] FFIEC, "Financial Regulators Highlight Coordination and Collaboration of Efforts to Address COVID-19," March 25, 2020, at https://www.ffiec.gov/press/pr032520.htm.

[55] Federal Reserve, "Federal Reserve offers regulatory reporting relief to small financial institutions affected by the coronavirus," press release, March 26, 2020, at https://www.federalreserve.gov/newsevents/pressreleases/bcreg20200326b.htm.

[56] Federal Reserve, FDIC, and OCC, "Agencies announce two actions to support lending to households and businesses," press release, March 27, 2020, at https://www.federalreserve.gov/newsevents/pressreleases/bcreg20200327a.htm. For more information on CECL, see CRS Report R45339, *Banking: Current Expected Credit Loss (CECL)*, by Raj Gnanarajah.

[57] An illustrative example of a program that is not covered in this report is the revived Primary Dealer Credit Facility, originally created by the Fed in 2008, which allows *primary dealers* to borrow short-term loans backed by collateral similar to how banks borrow from the discount window. Primary dealers are a group of large broker-dealers that are

Lending to Banks

Banks can directly access funding through the Fed's discount window, which allows banks to post illiquid assets as collateral for short-term loans at interest rates slightly higher than market rates (the federal funds rate). The discount window is always available to banks, but because it charges above market rates, these short-term loans are minimal during normal conditions. In periods of stress, however, discount window lending can ramp up quickly.

In a March 15, 2020, announcement, the Fed encouraged banks to borrow from its discount window to meet their liquidity needs.[58] The Fed lengthened the maturity of discount window loans to up to 90 days and reduced the discount rate to the top of the Fed's target for the federal funds rate, so that it is no longer significantly higher than market rates. The discount window can be ineffective at ensuring ample liquidity, if banks using it face stigma. For example, if a bank is perceived as financially weak because it borrows from the discount window, then it may be reluctant to do so. The March 15 announcement can be seen as an attempt to overcome that stigma problem. To date, the use of the discount window has been less than it was during the 2007-2009 financial crisis. Outstanding discount window lending peaked at $51 billion on March 25. It has fallen considerably since but remains elevated compared to its use in normal economic conditions. By contrast, discount window lending peaked at $110 billion in 2008, while a similar Fed facility that was created in response to the 2007-2009 financial crisis peaked at $493 billion in 2009.[59]

Banks can also access liquidity from the Fed through its payment systems. In the period between when a payment is initiated and settled, banks may receive *intraday credit* (temporary overdrafts) from the Fed if they need to use cash that they have not yet received from a pending payment. In normal conditions, the Fed discourages excessive use of intraday credit. But in the March 15 announcement, the Fed encouraged banks to take advantage of intraday credit. On March 23, the Fed announced that it was temporarily changing the terms of intraday credit to make it more attractive by waiving fees and limits on its use.[60] Additionally, the Fed delayed the upcoming implementation of a rule that would limit intraday credit for the U.S. operations of foreign banking organizations. The effective date was rescheduled from April 1 to October 1.[61]

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active in government securities markets. Most are nonbank subsidiaries of a U.S. bank holding company or a foreign banking operation that is operating in the United States but because they are not depositories, this type of facility is beyond the scope of this report.

For a more complete examination of the Fed's response to COVID-19, see CRS Report R46411, *The Federal Reserve's Response to COVID-19: Policy Issues*, by Marc Labonte.

[58] Federal Reserve, "Federal Reserve Actions to Support the Flow of Credit to Households and Businesses," press release, March 15, 2020, at https://www.federalreserve.gov/newsevents/pressreleases/monetary20200315b.htm (hereinafter Federal Reserve's March 15 Announcement). The other federal banking regulators also encouraged banks under their supervision to use the discount window on March 16, 2020.

[59] This facility, called the Term Auction Facility, has not been revived during the COVID-19 pandemic to date. For more information, see CRS Report R43413, *Costs of Government Interventions in Response to the Financial Crisis: A Retrospective*, by Baird Webel and Marc Labonte.

[60] Federal Reserve, "Temporary Actions to Support the Flow of Credit to Households and Businesses by Encouraging Use of Intraday Credit," Policy Statement, Docket no. OP-1716, March 23, 2020, at https://www.federalreserve.gov/newsevents/pressreleases/files/other20200423a1.pdf.

[61] Federal Reserve, "Federal Reserve Board announces implementation delay for changes to its Payment System Risk Policy regarding intraday credit," press release, March 24, 2020, at https://www.federalreserve.gov/newsevents/pressreleases/other20200324a.htm.

Policies Increasing Bank Reserves

One measure of a bank's liquidity is its reserves, which are measured as its vault cash and its deposits at the Fed. The Fed's actions in response to COVID-19 have greatly increased the Fed's balance sheet, and thus reserves available for use by banks to meet liquidity needs. In May 2020, bank reserves totaled $3.2 trillion, compared with around $40 billion from 2000 to 2007.[62] The Fed also temporarily reduced reserve requirements to zero, effective March 26, 2020.[63] In its announcement, the Fed noted that, due to changes in its operating framework that predate COVID-19, reserves are now so plentiful that reserve requirements are no longer a binding constraint. Reserve requirements are intended to ensure that banks hold adequate liquidity relative to deposits, but required reserves cannot be used to meet liquidity needs to the extent that the minimum balance must always be kept on hand.[64] As a result of this change, the Fed also eliminated the monthly transaction limit on savings accounts, which are not subject to reserve requirements.[65]

Congressional Response to Help Banks

The CARES Act provides wide-ranging assistance to consumers, businesses, and the financial services sector. A few provisions in Division A, Title IV of the CARES Act directly and indirectly pertain to banks. For instance, the CARES Act includes four sections—4011, 4012, 4013, and 4014—that temporarily relax some of the regulations banks face. Section 4008 allows the FDIC to create a temporary guarantee for certain uninsured accounts. Sections 4022 and 4023 impact mortgage servicers, many of which are banks.[66]

Concentration Limits (Section 4011)

To mitigate counterparty risk, national banks are subject to limits on how much they can lend to a single borrower relative to their capital and their portfolio characteristics, unless the loan qualifies for an exception enumerated by statute. The OCC generally has relatively narrow authority to approve certain loans for an exception to the limit. Section 4011 grants the OCC broad, temporary authority to exempt loans when doing so is "in the public interest." This authority terminates the earlier of (1) the date the public health emergency ends or (2) the end of 2020. To date, the OCC has not issued a rulemaking implementing this section.

Community Bank Leverage Ratio (Section 4012)

Banks face a variety of safety and soundness requirements regarding how much capital they must hold to protect against possible losses. Capital is a relatively expensive source of funding, so requiring higher levels can reduce the amount banks lend. Certain small banks can elect to be

[62] Federal Reserve Bank of St. Louis, "Total Reserves of Depository Institutions, not seasonally adjusted," at https://fred.stlouisfed.org/series/TOTRESNS.

[63] Although the elimination of reserve requirements was announced as temporary, the Fed also announced that it currently has no plans to reinstate them. Federal Reserve's March 15 Announcement.

[64] In practice, some reserve requirement rules related to averaging over time mitigate this perverse effect.

[65] Federal Reserve, "Federal Reserve Board announces interim final rule to delete the six-per-month limit on convenient transfers from the 'savings deposit' definition in Regulation D," press release, April 24, 2020, at https://www.federalreserve.gov/newsevents/pressreleases/bcreg20200424a.htm.

[66] For an overview, see CRS Report R46301, *Title IV Provisions of the CARES Act (P.L. 116-136)*, coordinated by Andrew P. Scott.

subject to a single, relatively simple—but relatively high—capital rule called the Community Bank Leverage Ratio (CBLR). Bank regulators are authorized to set the ratio between 8% and 10%. Prior to the enactment of the CARES Act, it was set at 9%. Section 4012 directs regulators to lower it to 8% and give banks that fall below that level a reasonable grace period to come back into compliance with the CBLR. This relief expires the earlier of (1) the date the public health emergency ends or (2) the end of 2020. The rulemaking implementing this section raises the CBLR to 8.5% in 2021, before returning it to 9% on January 1, 2022.[67]

For more information, see CRS Report R45989, *Community Bank Leverage Ratio (CBLR): Background and Analysis of Bank Data*, by David W. Perkins.

Troubled Debt Restructuring (Section 4013)

A Troubled Debt Restructuring (TDR) is a concession by a lender to a troubled borrower that it would not generally consider under normal circumstances. Generally Accepted Accounting Principles (GAAP)[68] require the lender to reflect in its financial records any potential loss as a result of a TDR. Recording of such losses could negatively impact the lender's ability to meet regulatory requirements. Section 4013 requires federal bank and credit union regulators to allow lenders to determine if they should suspend the GAAP requirements in recognition of any potential COVID-related losses from a TDR related to a loan modification. This relief expires the earlier of (1) 60 days after the public health emergency declaration is lifted or (2) the end of 2020. On April 7, 2020, the regulators issued a joint statement providing guidance on how banks and credit unions should treat loans modified under Section 4013.[69]

In April, the agencies also issued revised guidance that included information about loan modifications.[70] The interagency statement allows banks to provide certain modifications to loans without designating them as a TDR if the modifications are related to COVID-19.

Current Expected Credit Loss (Section 4014)

Credit loss reserves help a financial institution absorb write-downs on loans and other assets. The loss reserves give a financial institution a cushion before it is required to adjust income or bank capital to reflect the losses from change in the asset value. In response to banks' financial challenges during and after the 2007-2009 financial crisis, the Financial Accounting Standards Board promulgated a new credit loss standard—CECL—in June 2016. CECL requires early recognition of losses as compared to the current methodology. All public companies were required to issue financial statements incorporating CECL for reporting periods beginning December 15, 2019. Section 4014 gives banks and credit unions the option to temporarily delay CECL implementation until the earlier of (1) the date the public health emergency ends or (2) the end of 2020.

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[67] Federal Reserve, OCC, and FDIC, "Agencies Announce Changes to the Community Bank Leverage Ratio," press release, April 6, 2020, at https://www.fdic.gov/news/news/press/2020/pr20048.html.

[68] For more on Generally Accepted Accounting Principles (GAAP), see https://www.fasb.org/facts/index.shtml.

[69] OCC, "Agencies Issue Revised Interagency Statement on Loan Modifications by Financial Institutions Working with Customers Affected by the Coronavirus," press release, April 7, 2020, at https://www.occ.gov/news-issuances/news-releases/2020/nr-ia-2020-50.html.

[70] CFPB, Federal Reserve, FDIC, NCUA, OCC, and Conference of State Bank Supervisors, "Interagency Statement on Loan Modifications and Reporting for Financial Institutions Working with Customers Affected by the Coronavirus," March 22, 2020, at https://www.fdic.gov/news/news/press/2020/pr20038a.pdf.

As mentioned in the "Accounting Standards" section earlier in the report, in the bank regulators' joint interim final rule implementing a CECL delay, the bank regulators used their existing authority to delay the rule further than mandated. The interim rule, as implemented, allows banks to delay CECL's adoption for up to two years. The new CECL rule also delays the accumulation of regulatory capital by two years. As before, the new CECL rule allows accumulation of regulatory capital to meet CECL's requirements over three years after the initial two-year delay.[71] As a result, banks will not have to account for future COVID-19-related losses as quickly.

For more information, see CRS Report R45339, *Banking: Current Expected Credit Loss (CECL)*, by Raj Gnanarajah.

Guaranteeing Transaction Accounts (Section 4008)

Section 4008 of the CARES Act authorizes the FDIC to temporarily guarantee certain deposits that are not eligible for regular FDIC deposit insurance due to the existing $250,000 per account insurance limit. The provision does this by broadening the FDIC authority under Section 1105 of the Dodd-Frank Act to guarantee bank debt in the event of a financial liquidity crisis by allowing the FDIC to guarantee deposits in *noninterest bearing transaction accounts* in addition to bank debt. By giving the FDIC this authority, a noninterest bearing transaction account (a type of account that typically exceeds the deposit insurance limit and is held by businesses and local governments) can be given a government guarantee. The intent of this measure is to reduce the likelihood that holders of these accounts make mass withdrawals in a short period of time, called a *bank run*, in response to uncertainty over individual bank solvency or banking system stability. Section 4008 preemptively grants the requisite congressional approval for any such program needed to respond to the COVID-19 pandemic, provided the FDIC guarantee terminates the program no later than December 31, 2020.[72] To date, the FDIC has not created a guarantee under this authority.

For more information, see CRS Insight IN11307, *The CARES Act (P.L. 116-136) Section 4008: FDIC Bank Debt Guarantee Authority*, by David W. Perkins.

Mortgage Forbearance (Section 4022 and 4023)

The CARES Act includes two sections intended to provide temporary relief for certain affected mortgage borrowers:

- Section 4022 provides for forbearance and a foreclosure moratorium for federally backed single-family mortgages; and
- Section 4023 provides for forbearance for federally backed multifamily mortgages.

The forbearance provisions in the CARES Act apply to federally-backed mortgages.[73] Several federal agencies insure or guarantee single-family mortgages, multifamily mortgages, or both—

[71] OCC, "Regulatory Capital Rule: Revised Transition of the Current Expected Credit Losses Methodology for Allowances," 85 *Federal Register*, March 31, 2020. For more on CECL, see CRS Report R45339, *Banking: Current Expected Credit Loss (CECL)*, by Raj Gnanarajah.

[72] Section 4008 also authorizes the NCUA to increase their share insurance limit—the credit union equivalent of deposit insurance—to an unlimited amount for noninterest bearing transaction accounts, provided the increase expires by December 31, 2020. To date, the NCUA has not used this authority to raise the limit.

[73] A *federally-backed mortgage* is broadly defined in the legislation to include loans insured, guaranteed, or originated by the Department of Housing and Urban Development through the Federal Housing Administration and the Section

the CARES Act provisions cover all of these, including Federal Housing Administration-insured reverse mortgages. The federal housing agencies have generally implemented these provisions; however, forbearance on federally backed mortgages also pertains to the banking regulators, as many of the servicers of federally backed mortgages are banks. On April 3, 2020, bank regulators issued guidance encouraging mortgage servicers to place consumers in short-term forbearance programs, consistent with the CARES Act, stating that they are taking a "flexible supervisory and enforcement approach" to ensure that servicers are able to do this without further straining their operational capacity. [74]

For more information, see CRS Insight IN11334, *Mortgage Provisions in the Coronavirus Aid, Relief, and Economic Security (CARES) Act*, by Katie Jones and Andrew P. Scott.

Outlook

As the financial implications of the coronavirus pandemic unfold for banks in the coming months to years, there are reasons to be optimistic. The banking industry as a whole is in a better position to withstand losses and an economic downturn than at other times in recent history, due to changes in bank regulation and behavior made in response to the 2007-2009 financial crisis.

A number of regulatory actions and provisions in the CARES Act are aimed at easing pressures banks may face as they deal with effects of the pandemic. Yet, it seems likely that banks will incur previously unexpected and potentially large losses on their loans to households and businesses. For 535 banks, these loans make up more than 70% of the value of their total assets, and the average capital buffer at those banks relative to the size of that exposure is smaller compared with less concentrated banks. By one metric, 87 banks are in danger of becoming seriously distressed.

There is great uncertainty surrounding how long the economic disruption from COVID-19 will last. Borrowers would be better able to maintain or resume loan payments if economic conditions normalize quickly. If they do not, banks face potential losses that could be larger than safety and soundness regulation is intended to guard against. Thus, while many U.S. banks are well-positioned to absorb potential coronavirus-related losses, segments of the industry could come under distress, and a number of banks could fail.

184 and Section 184A programs for Native Americans and Native Hawaiians, respectively; the Department of Veterans Affairs; the U.S. Department of Agriculture (which also directly originates some mortgages); or purchased and securitized by the government-sponsored enterprises Fannie Mae and Freddie Mac.

[74] CFPB, Federal Reserve, FDIC, NCUA, OCC, and Conference of State Bank Supervisors, "Joint Statement on Supervisory and Enforcement Practices Regarding the Mortgage Servicing Rules in Response to the COVID-19 Emergency and the CARES Act," press release, April 3, 2020, at https://www.federalreserve.gov/newsevents/pressreleases/files/bcreg20200403a1.pdf.

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