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INSIGHT

COVID-19-Related Impact on the Banking Industry: Conditions in the First Quarter 2021

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Although bank regulation is designed to allow banks to withstand some amount of unexpected losses, some worry that the economic ramifications of the COVID-19 pandemic could result in enough borrowers missing loan payments to cause distress for banks. This Insight presents certain bank industry statistics for the first quarter 2021 and examines how the pandemic might be affecting the industry.

Background

Economic downturns jeopardize bank income as the likelihood of losses from missed payments increases, ultimately reducing bank profitability. Meanwhile, bank liabilities—the deposits they hold and the debt they owe—obligate banks to make funds available to depositors and creditors. If borrower repayments decline enough, a bank's ability to meet its obligations could become impaired, potentially causing it to fail. In contrast, bank capital—largely equity stock and retained profits from earlier periods—enables a bank to absorb a certain amount of losses without failing. For this reason, bank regulators require banks to hold certain amounts of capital (in addition to subjecting them to a variety of safety and soundness regulations) to avoid failures.

Certain effects of, and bank responses to, economic downturns—such as reduced income and increased credit loss reserves—occur shortly after the onset of economic deterioration. Other effects—such as increased loan delinquency, incurred losses, and reduced capital value—occur after a longer lag. (See CRS Insight IN11501, *COVID-19 Impact on the Banking Industry: Lag Between Recession and Bank Distress*.) Currently, the bank industry appears to be holding up well. However, as the pandemic continues to affect the economy and the option to request loan forbearances expires on September 30, 2021, signs of stress may emerge.

The Federal Deposit Insurance Corporation (FDIC) releases comprehensive data on bank condition and income quarterly. The *Quarterly Banking Profile: First Quarter 2021* reports aggregate data from all 4,978 FDIC-insured institutions as of March 31, 2021.

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Income and Loss Reserves

First quarter 2021 profit for the banking industry was $76.8 billion (see **Table 1**), a 315% increase from the first quarter 2020. The year-over-year increase came mainly from banks decreasing credit loss reserves. Credit loss reserves account for potential future losses on loans and other assets by adjusting income on those loans and assets. First quarter 2020 profit for the banking industry was $18.5 billion as banks provided for credit losses and other impairment charges. Banks greatly increased reserves early in the pandemic, likely in response to the fear that the pandemic would cause widespread losses—accounting for $132.2 billion in credit loss expenses in 2020, a 140% increase from 2019 expenses at $55.1 billion. In addition, net interest income in 2020 declined by $20.0 billion (or 3.7%) as the average net interest margin (the difference between the interest rates banks earn and pay out) decreased to 2.82% from 3.36%.

Another possible contributing factor to the increase in credit reserves losses in early 2020 might have been the adoption of a new credit loss reserve standard—Current Expected Credit Loss (CECL)—which requires earlier recognition of losses. Although CECL was required to be implemented by the largest banks beginning December 15, 2019, the CARES Act (P.L. 116-136) delayed the authority of the regulators to require banks to use CECL until the earlier of the end of the public health emergency or the end of 2020. The bank regulators also gave banks the option to delay the use of CECL for two years, followed by a three-year transition period. To date, 320 banks have made the transition to using CECL, and 4,658 banks have not yet. Reportedly, most of the largest banks that collectively hold nearly 80% of the industry's assets are among those using CECL. This makes it difficult to determine to what extent the recent changes in loss reserve statistics are the result of the pandemic. For more information on CECL, see CRS Report R45339, *Banking: Current Expected Credit Loss (CECL)*.

Table 1. Banking Income and Credit Loss Reserve Expenses

	Q1 2021	Q1 2020	Q1 2019
Net income	$76.8 billion	$18.5 billion	$60.7 billion
Credit loss reserve expenses	-$14.5 billion	$52.7 billion	$13.9 billion

Source: FDIC, *Quarterly Banking Profile: Fourth Quarter.*

Loan Performance and Capital

Loan performance and capital levels—two indicators that deteriorate after a time lag—have yet to be significantly affected by the pandemic.

The noncurrent loan rate (i.e., percent of loans more than 90 days past due or in nonaccrual status) increased during the first quarter of 2021. However, as part of an exception allowed under the CARES Act, banks are not yet reporting loans in forbearance as noncurrent. The noncurrent rate as of the first quarter 2021 was 1.14%, an increase from the first quarter 2020 at 0.93% and from the first quarter 2019 at 0.99% (see **Table 2**). For context, after the 2007-2009 financial crisis, the rate peaked at 5.46% in the first quarter of 2010.

Loan *charge-offs* (when a bank gives up on a loan and writes off the loan's reported value from its assets) ticked down from a year ago in first quarter of 2021. The net charge-off rate was 0.34%, down from 0.55% a year earlier. The post-financial crisis rate peaked at 3.00% in the fourth quarter 2009.

Banks added $135 billion in bank equity capital since the first quarter 2019. In the last crisis, bank equity capital decreased by $44.9 billion, or 3.3%, in the third quarter 2008. The increase in capital was mainly due to retained earnings—that is, profits that were not distributed to shareholders as dividends.

Table 2. Loan Performance and Capital

	Q1 2021	Q1 2020	Q1 2019
Noncurrent rate	1.14%	0.93%	0.99%
Net charge-off rate	0.34%	0.55%	0.09%
Bank equity capital (BEC)	$2,250 billion	$2,115 billion	$2,056 billion
BEC annual change	$135 billion	$59 billion	n/a

Source: *Quarterly Banking Profile: Fourth Quarter*.

The number of banks on the FDIC's "Problem Bank" list increased by one, to 55, from the fourth quarter 2020 to the first quarter 2021. No banks have failed in 2021 thus far.

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