

Supervisory Update: Continuing to Navigate the Current Environment

Supervision, Regulation, and Credit (SRC)

August 26, 2021

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Address your question to "all panelists"



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Continuing to Navigate the Current Environment

Mike Johnson, Executive Vice President

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Federal Reserve
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Supervisory Posture (Safety & Soundness)

Steve Wise, Vice President
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Additional Information



Ask the Fed® ***"Update on The Federal Reserve's Supervisory Posture for Small Banks."***
On **Thursday, August 19**: Executive Vice President of Supervision and Regulation at the Federal Reserve Bank of Chicago Julie Williams and Assistant Director of Regional Firm Supervision at the Board of Governors Keith Coughlin provided an update for small banks as pandemic conditions improve.

If you missed it, you can register and log-in at www.askthefed.org to watch the replay of this session and others of interest in the archives.

Scaled CECL Allowance for Losses Estimator (SCALE) Tool

David Schwartz, Principal Examiner

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Scaled CECL Allowance for Losses Estimator Method

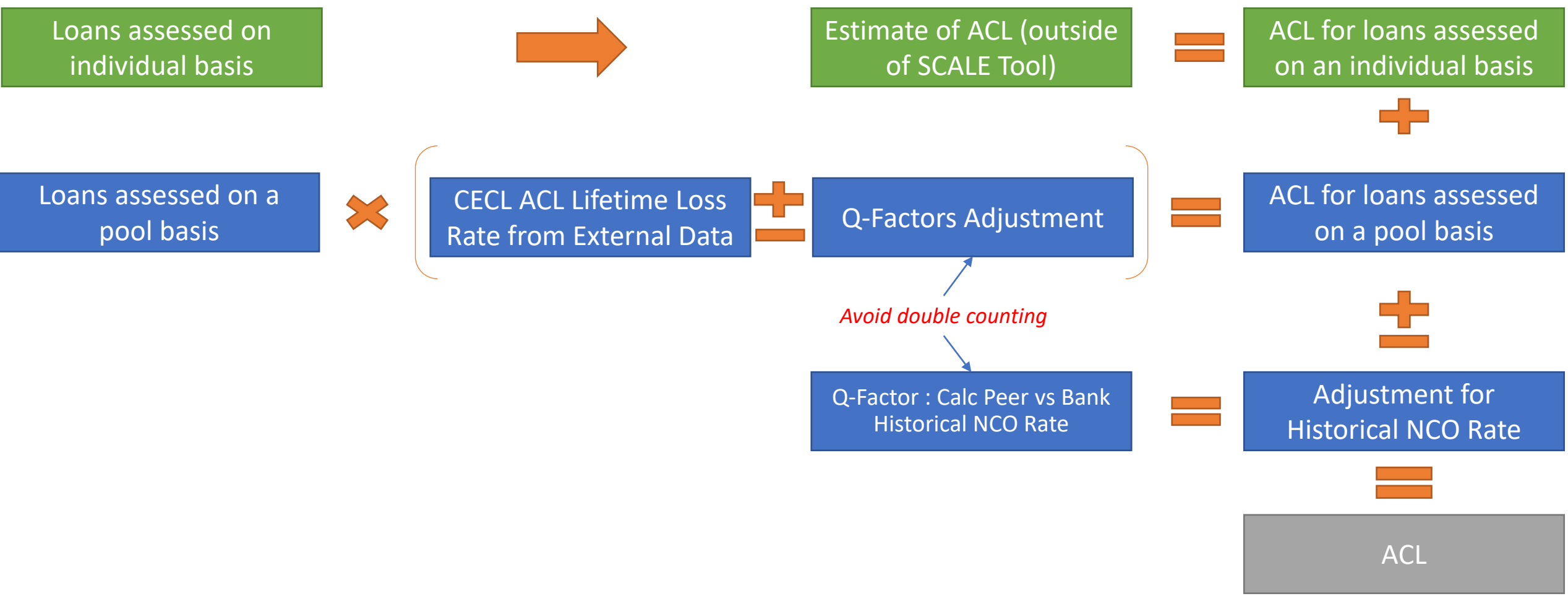
SCALE Method – Who, What, Where, When and Why?

- One of many methods for estimating the ACL under CECL
- Demonstrates operational flexibility and scalability of CECL
- Certain community banks with total assets of \$1 billion or less
- CECL Resource Site (<https://www.supervisionoutreach.org/cecl>)

SCALE's use does not ensure compliance with U.S. GAAP.

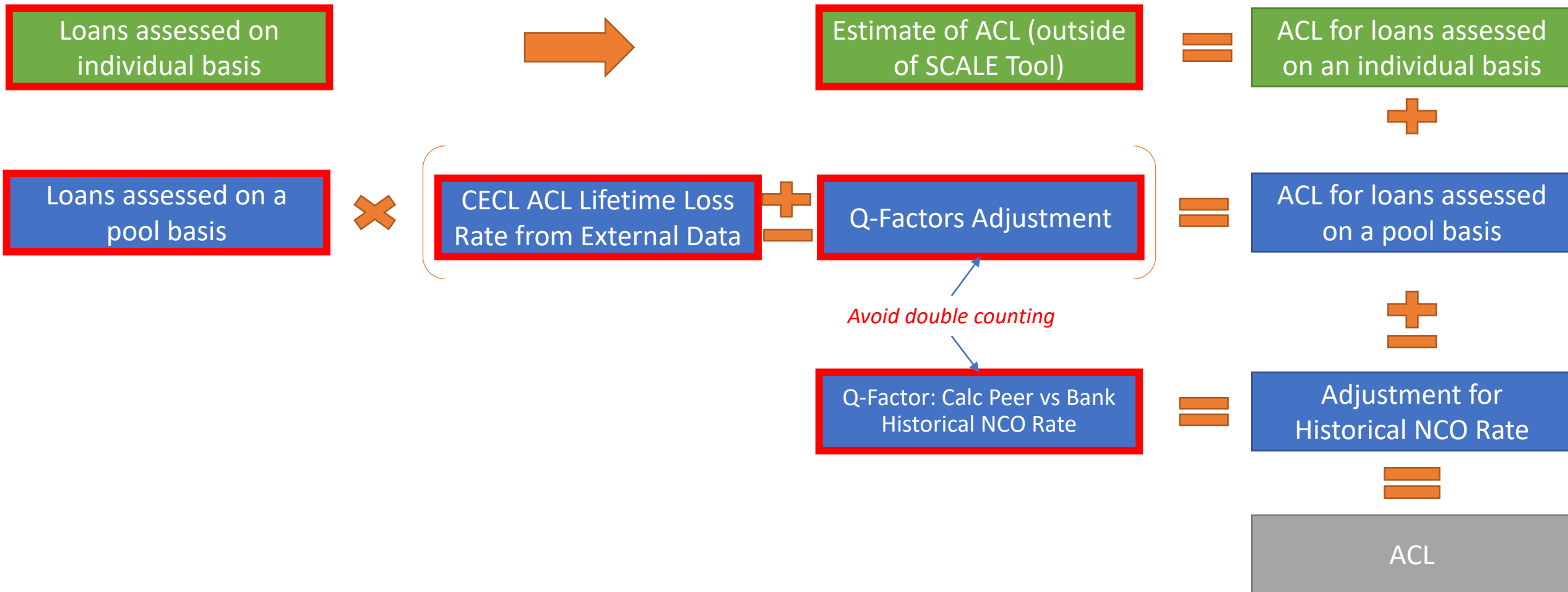
SCALE Method

The recipe



Where is Management Judgement Required?

Boxes outlined in red require judgement



Does SCALE's Use Change Governance Responsibilities?

Board's and management's responsibilities remain the same

- Choice of appropriate method for estimating ACL based on size, complexity and risk profile
- Adjustments must be made based on bank's unique facts and circumstances
- Sound internal credit risk management practices and internal controls over ACL

Supervisory Expectations

Supervisory expectations in Interagency Policy Statement on ACL remain!

- Not a regulatory preferred nor a safe harbor method
- Examiners continue to assess adequacy of processes and appropriateness of allowance
- Examiners may question choice of using SCALE as well as inputs and adjustments
- Support and document rationale for key judgements

Items to Consider

Is SCALE right for your institution?

- Complexity and risk profile
- Institution size and plans for growth
- Stakeholders
- Inputs and adjustments (including Q-Factors)
- Internal controls process

Management is responsible for ensuring that the ACLs conform with U.S. GAAP and adequately covers credit risk.

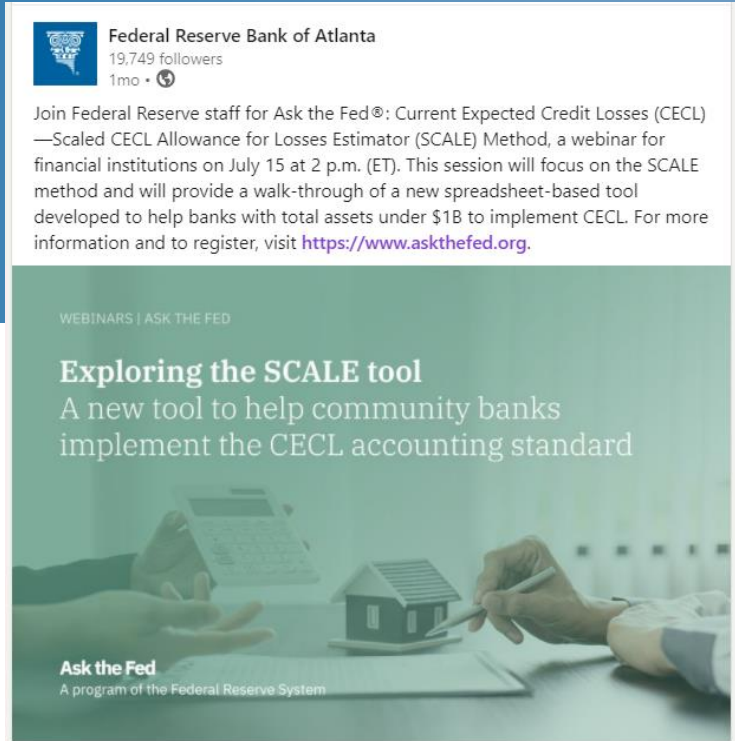
Additional Information

FASB

- [Transition Resources Group for Credit Losses](#)

Federal Reserve

- SCALE Related Resources:
 - [Ask the Fed Webinar - CECL: Scaled CECL Allowance for Losses Estimator \(SCALE\) Method \(July 15, 2021\)](#)
 - [SCALE Tool](#)
 - [SCALE Tool Instructions](#)
 - [SCALE Tool Frequently Asked Questions](#)
- [Ask the Regulators: Practical Methods Smaller, Less Complex Community Banks Can Use as a Starting Point for CECL \(March 2018\)](#)
- [Interagency Policy Statement on Allowances for Credit Losses](#)
- [Frequently Asked Questions on the Current Expected Credit Losses Methodology \(CECL\)](#)
- [CECL Resource Center](#)



Final thoughts...

Does SCALE get the right number?

“Close don't count in baseball. Close only counts in horseshoes and hand grenades.”

- Frank Robinson, Professional Baseball Player and Manager

Polling Question

Based on your current understanding, do you think SCALE would be useful in measuring and reporting your ACLs?

- (1) Yes
- (2) No
- (3) Not sure
- (4) Not applicable

Questions and Additional Information

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Acronyms

ACL: allowances for credit losses

CECL: current expected credit losses

FASB: Financial Accounting Standards Board

GAAP: generally accepted accounting principles

IPS: interagency policy statement

SCALE: Scaled CECL Allowance Loss Estimator

Schedule RI-C: Disaggregated Data on the Allowance for Loan and Lease Losses

UBPR: Uniform Bank Performance Report

Q&A Session

To ask a question – use the WebEx chat.

Address your question to "all panelists"



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CRA Modernization

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CRA Modernization Update

- Federal Reserve Published ANPR to modernize CRA in September 2020
- Modernization Objectives:
 - Strengthen regulations to better meet the CRA's core purpose to address inequities in credit access for LMI communities and ensure an inclusive financial services industry
 - Update standards in light of changes to banking over time, including mobile and internet banking
 - Provide greater certainty, tailor regulations, and minimize burden
- Comment window closed in February 2021
 - Approximately 600 comments received

Themes from Comment Review: Areas of Support

Supported by both banks and community organizations:

- Overall evaluation framework including proposed uses of metrics, separate tests for retail lending, retail services, community development financing, and community development services, and tailoring to bank size, business model, and local conditions.
- Updated community development definitions and emphasis on activities with MDIs and CDFIs
- A pre-approval process and illustrative list of qualifying activities to increase certainty.
- Encouraging CRA activities in areas of need such as Indian Country, banking deserts, and underserved rural areas, even when outside of a bank's designated assessment areas
- Retaining High Satisfactory and Low Satisfactory conclusions.
- Exempting small banks from deposit data collection and reporting.

Themes from Comment Review: Areas of Differences

- Asset thresholds: Community groups support the current asset threshold for differentiating between small and large banks, while industry groups support a higher threshold.
- Assessment areas: Community groups support requiring local assessment areas where banks are active but do not have branches, while industry groups oppose a deposit- or lending-based approach.
- Data requirements: Industry groups are wary of new data requirements while community groups generally support additional data collection

Themes from Comment Review: Areas of Differences

- Retail test (retail lending and retail services):
 - Community groups prefer more stringent and detailed retail lending metrics, and a more rigorous examination of branch locations and deposit products.
 - Industry groups support using retail lending metrics to establish a presumption of a Satisfactory conclusion, but generally support more simplified metrics; prefer more flexibility on retail services evaluations.
- CD Services: Community groups favor requiring that volunteer activities under the community development services test be related to financial services, while industry groups prefer greater flexibility.
- Racial considerations: Community groups favor direct consideration of race and ethnicity of customers and communities in CRA evaluations; industry groups did not comment on how CRA should address structural inequities.

CRA Modernization Next Steps

- Federal Reserve, FDIC and OCC released a joint statement in July that we would be working together to modernize and strengthen the CRA regulation, building from the Federal Reserve's ANPR.

Polling Question

Where would you like to see CRA reform?

1. Defining assessment areas: where CRA performance is considered
2. Transparent and consistent performance tests (lending, community development and services)
3. Clarifying definitions of what activities qualify for CRA
4. Updated asset thresholds for small and large banks

COVID-19 CRA-Related Considerations

Joint Statement on CRA Consideration for Activities in Response to COVID-19. March 2020

[The Fed - CA 20-4 CRA Consideration for Activities in Response to the Coronavirus \(federalreserve.gov\)](#)

Interagency FAQs on CRA-Related to COVID-19. Updated March 2021

[The Fed - CA 21-5 Community Reinvestment Act \(CRA\) Consideration for Activities in Response to the Coronavirus \(federalreserve.gov\)](#)

Banking Applications Hot Topics

Sabrina Francis, Director of Examinations

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What is Happening in the World of Applications

- Overall volume is trending down; however, increased M&A
- Increased interest in Fed Memberships
- More complex cases including nonbank subsidiaries of holding companies
- Financial Services Companies interested in becoming bank holding companies

The Goal of the Applications Process

- Clear understanding of the details of the proposal
- Request additional information to fill information gaps
- Identify issues as early as possible and communicate with the Applicant/Notificant
- Ensure that all relevant statutory factors are consistent with approval

Statutory Factors

- Financial – Ratings, capital, source of strength, acquisition debt, business plan/ strategy, stock offering
- Managerial - Competence, experience, and integrity, risk management, internal controls, compliance
- Future prospects – pro forma financial data, integration plan, impact of the transaction, and due diligence

Considerations

- Legal Requirements – Stockholder Protection Arrangements, Prior Control Considerations
- CRA, Consumer Compliance, and Protest
- Competitive Factors/ Convenience and Needs

Considerations

- CAMELS ratings – Composite and Components
- Change in Bank Control
- BSA/IT/Risk Management
- Relocating main office

Applications Guidance

- [SR Letter 15-11/CA 15-9](#), Examinations of Insured Depository Institutions Prior to Membership or Merger into a State Member Bank
- [SR Letter 14-2/CA 14-1](#) - Enhancing Transparency in the Federal Reserve's Applications Process
- [SR Letter 13-7/CA letter 13-4](#) - State Member Bank Branching Considerations
- [SR Letter 12-12/CA 12-11](#) - Pre-filing Process

Pre-Filing Process: SR 12-12/CA 12-11

- Beneficial to Community Banking Organizations that do not file frequent applications or novel proposals
- Applies to all types of proposals requiring submission of an application or notice
- Participation in the process is optional
- Time frame is typically 60 days

WE WORK AS A TEAM - Collaboration Is Key

- Applications
- Safety & Soundness
- Consumer Affairs
- Legal
- Board Staff
- Other Regulators

Applications Resources

- Federal Reserve Bank of Atlanta Applications website
<https://www.atlantafed.org/banking-and-payments/supervision-and-regulation/banking-applications.aspx>
- Board of Governors website
www.federalreserve.gov
- Phone Consultations: phone numbers on website
- Virtual Meetings

Polling Question

Shares of my bank or bank holding company are being sold in a stock offering or a stockholder has decided to liquidate their shares. When should I consult with the Reserve Bank?

- A If an individual plans to purchase or will have the authority to vote 10 percent or more of the outstanding stock.
- B If a family group or group acting in concert as defined under section 225.41(b)(3) or 225.41(d) of Regulation Y and the ownership structure could potentially change.
- C If a shareholder group has 10 percent or more shares and wants to transfer shares to a trust for estate planning purposes.
- D All of the above.

Q&A Session

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Economic and Commercial Real Estate Update

Lauren Terschan, Senior Financial Specialist

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Polling Question

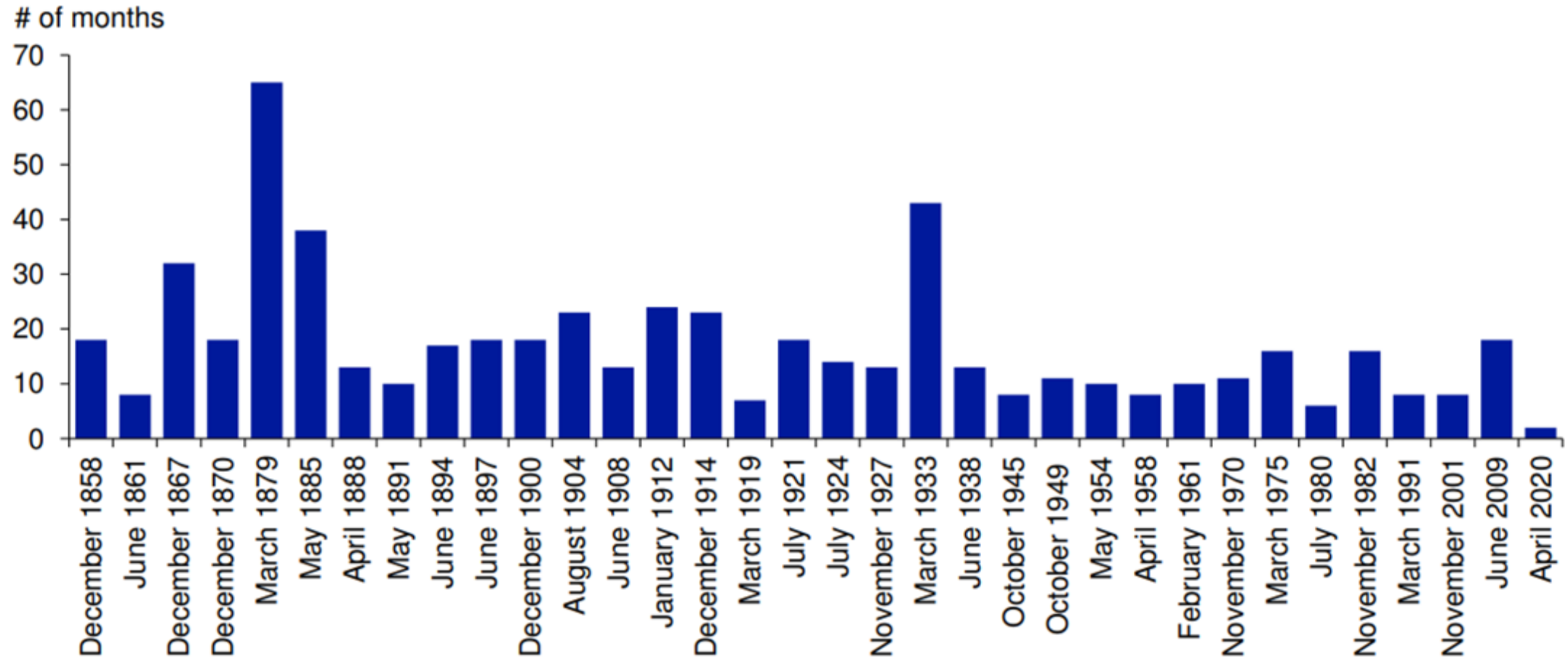
About which property sector do you have the most concern?

- Hotel
- Industrial
- Multifamily
- Office
- Retail

Agenda

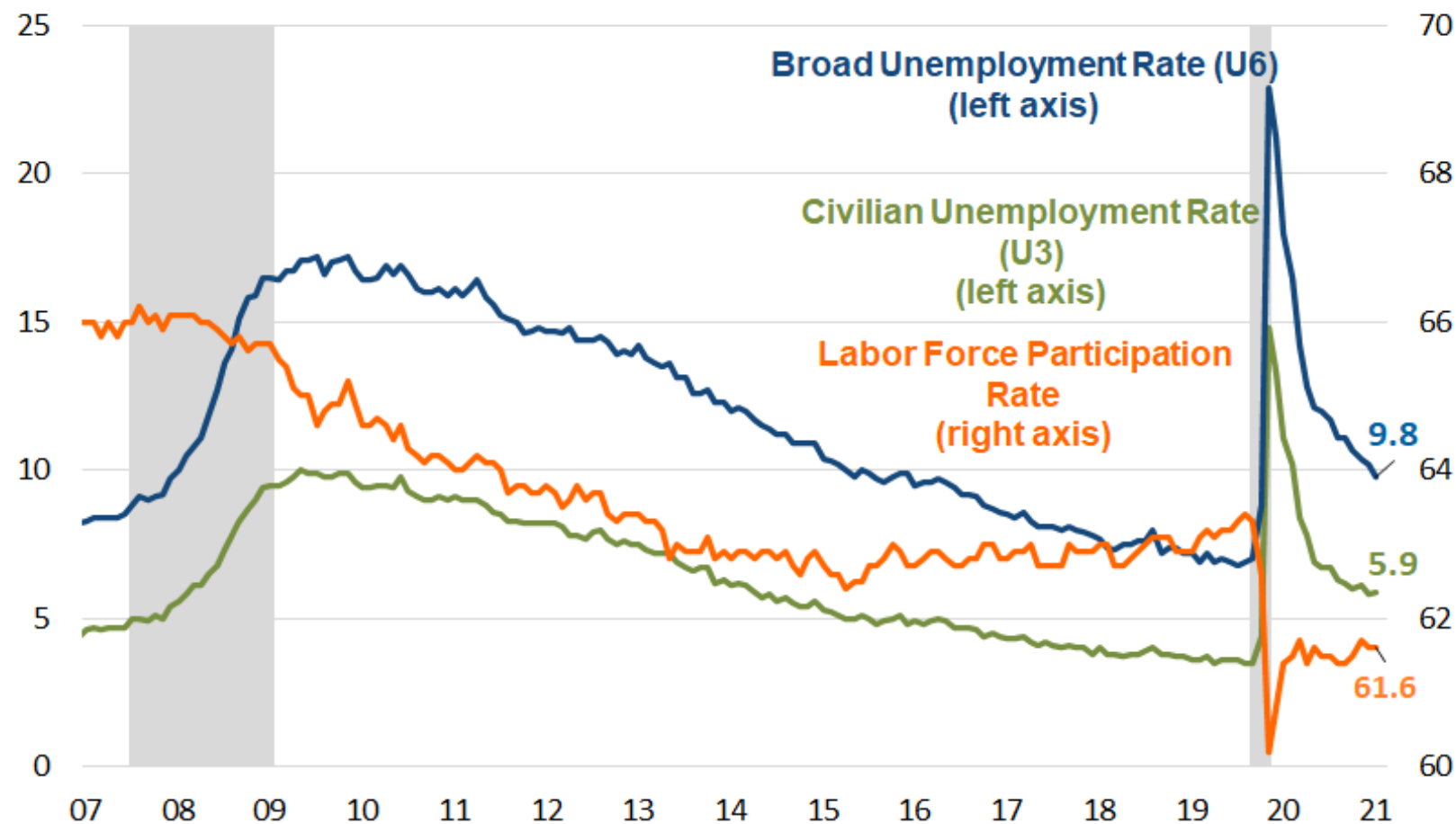
- **Economic Conditions**
- **CRE Market Trends**
- **CRE Momentum Index**
- **Questions**

U.S. Recession Lengths by Months



Note: dates refers to the month the recession ended
Source : NBER, Deutsche Bank

Unemployment



Current Unemployment Rate

U-3: 5.9%

U-6: 9.8%

Within two months U-3 went from a 50-year low to a 70-year high

U-6 which represents a broader view of unemployment increased over 3X in 2 months.

Both U-3 & U-6 have declined significantly since the onset of the pandemic.

Low-skilled workers have taken the brunt of displacements. This segment took a longer time to get back in the workforce coming out of 2009 recession.

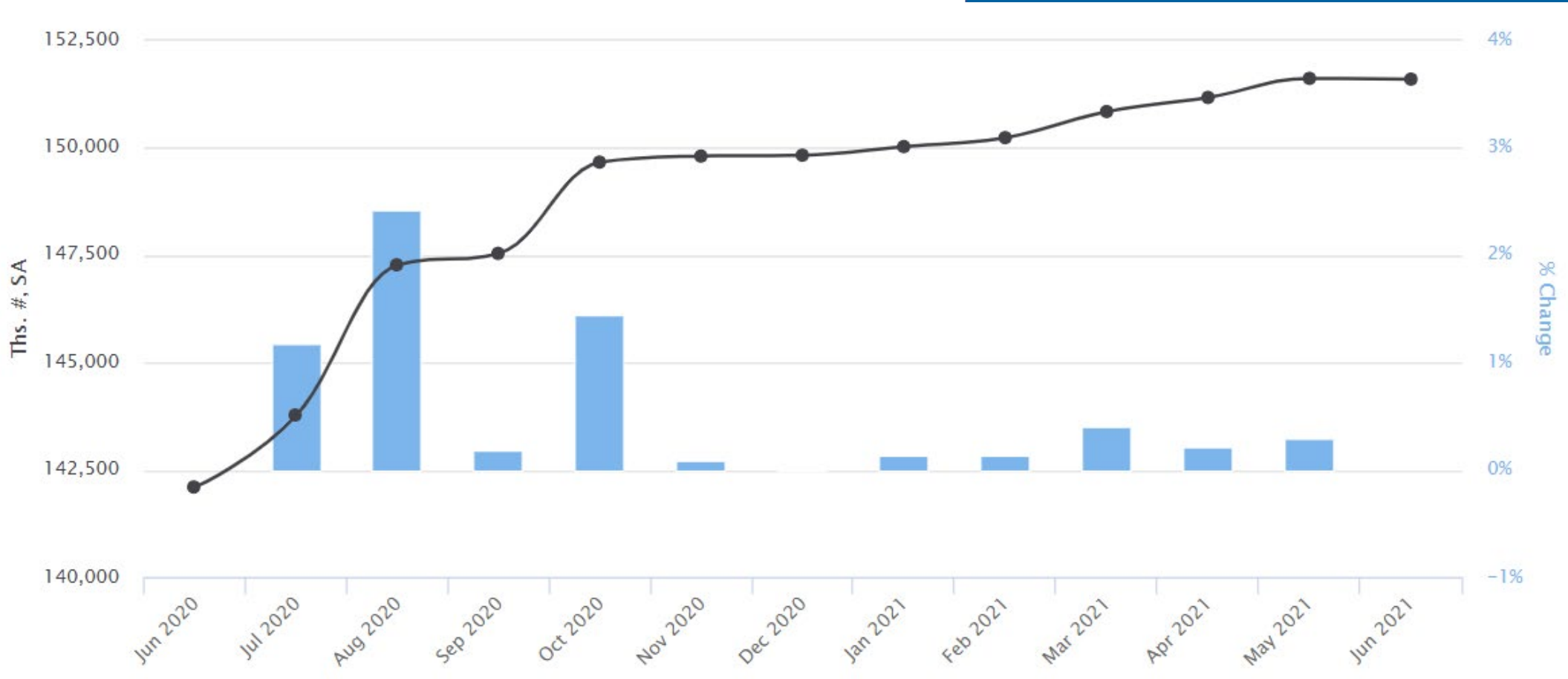
Labor Markets

2.2%

Of the labor force reporting continued + initial unemployment claims through June

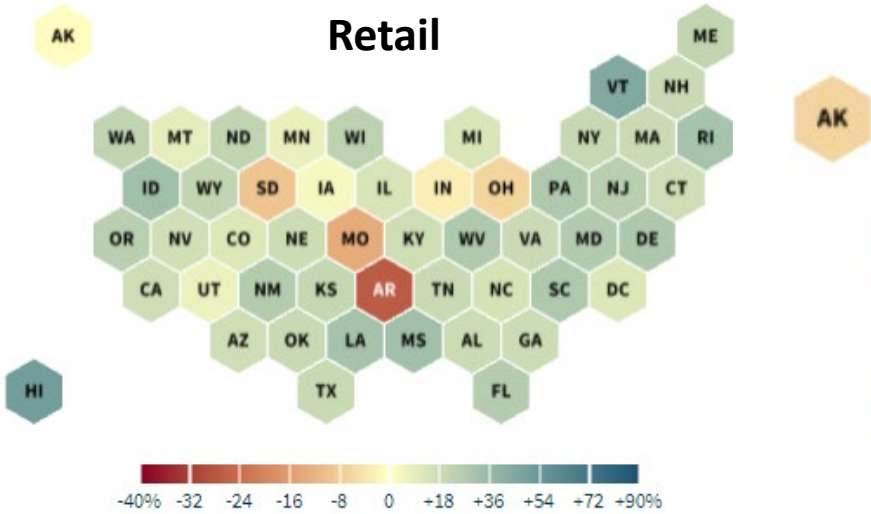
35.9%

Fewer hires than job openings as of May 2021

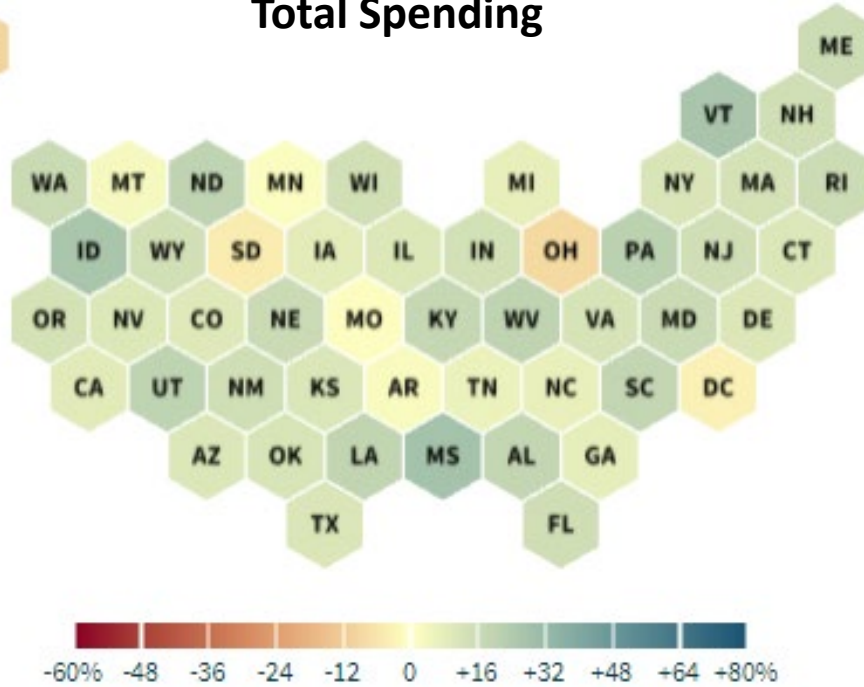


Consumer Spending Softens Again

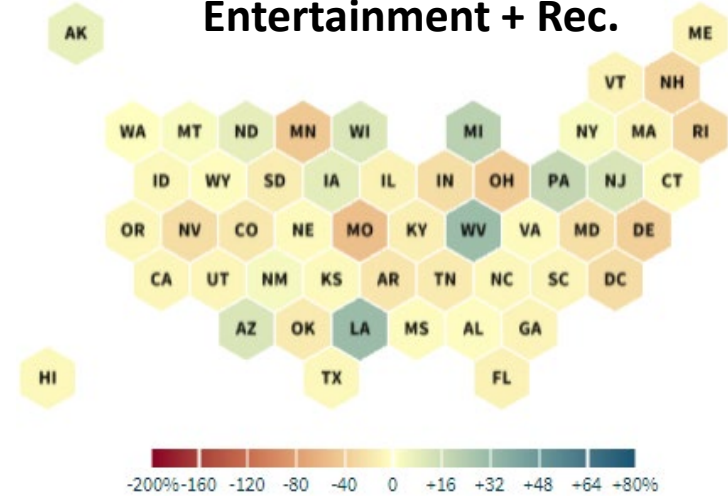
Retail



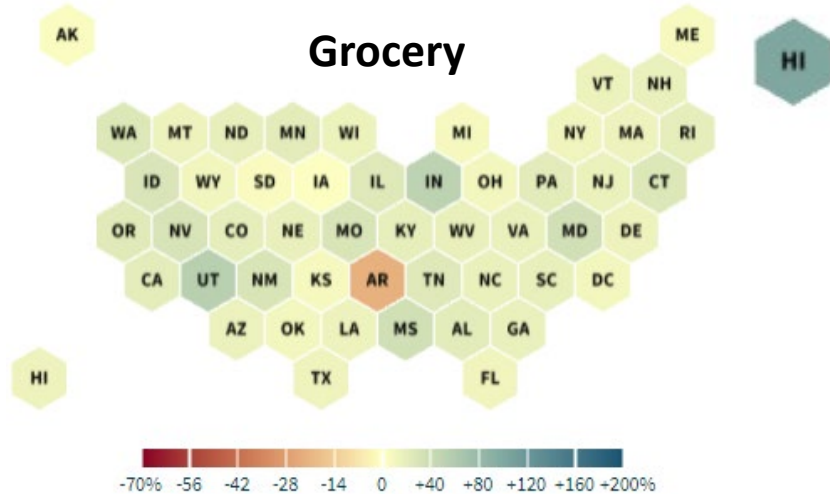
Total Spending



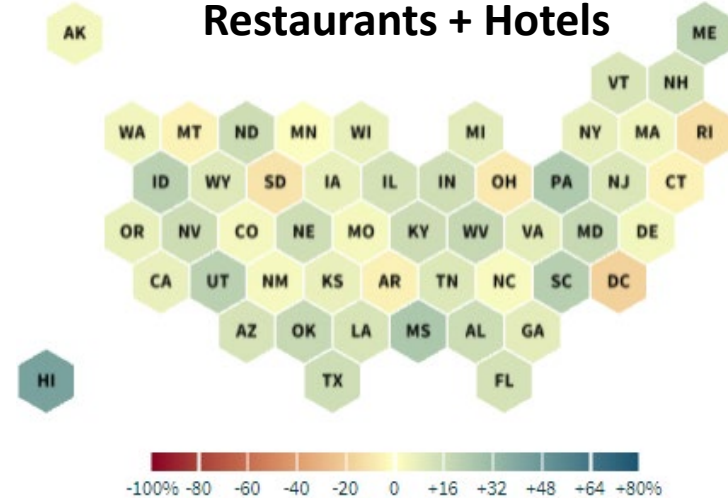
Entertainment + Rec.



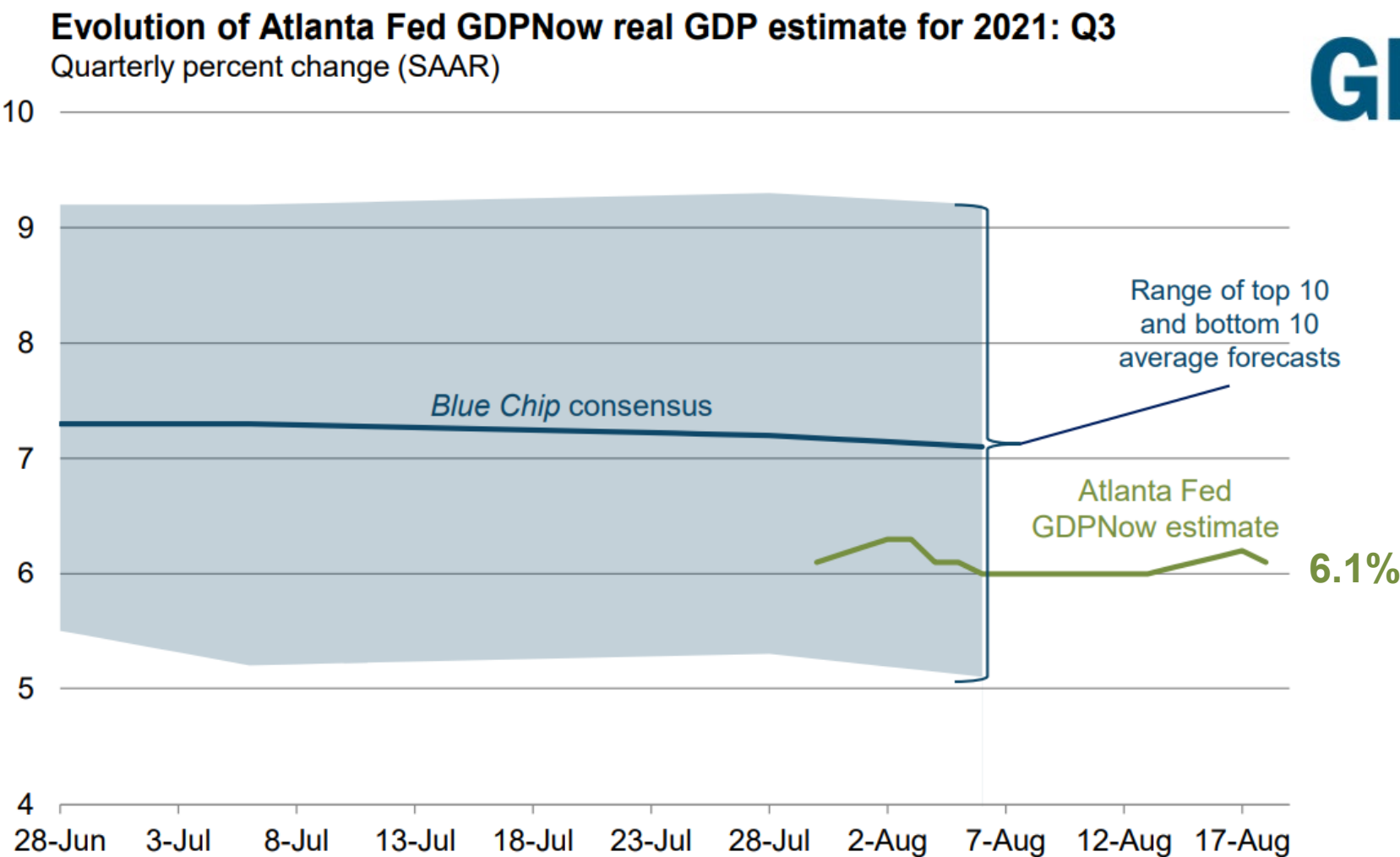
Grocery



Restaurants + Hotels

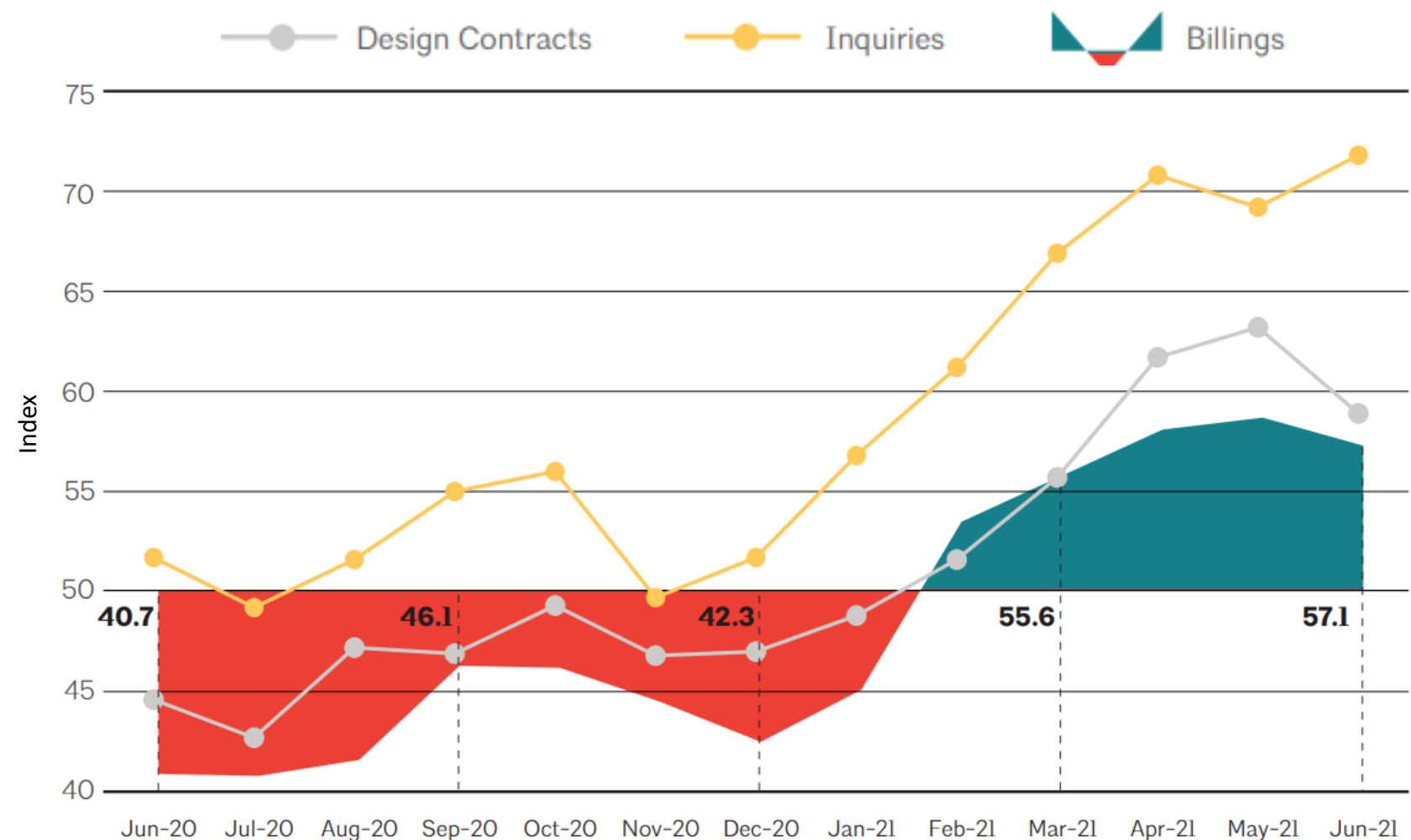


GDPNow vs. Forecasts



GDPNow™

Architectural Billings



- A result below 50 indicates activity is contracting, while above 50 represents an expansion.
- Inquiries are expanding which indicate improved prospects for future activity
- Activity associated with Design Contracts and Billings turned positive in February, signaling that activity levels have reached a point of inflection.

Source: Architectural Billing Index, Risk Analysis Unit/Federal Reserve Bank of Atlanta

CRE Landscape

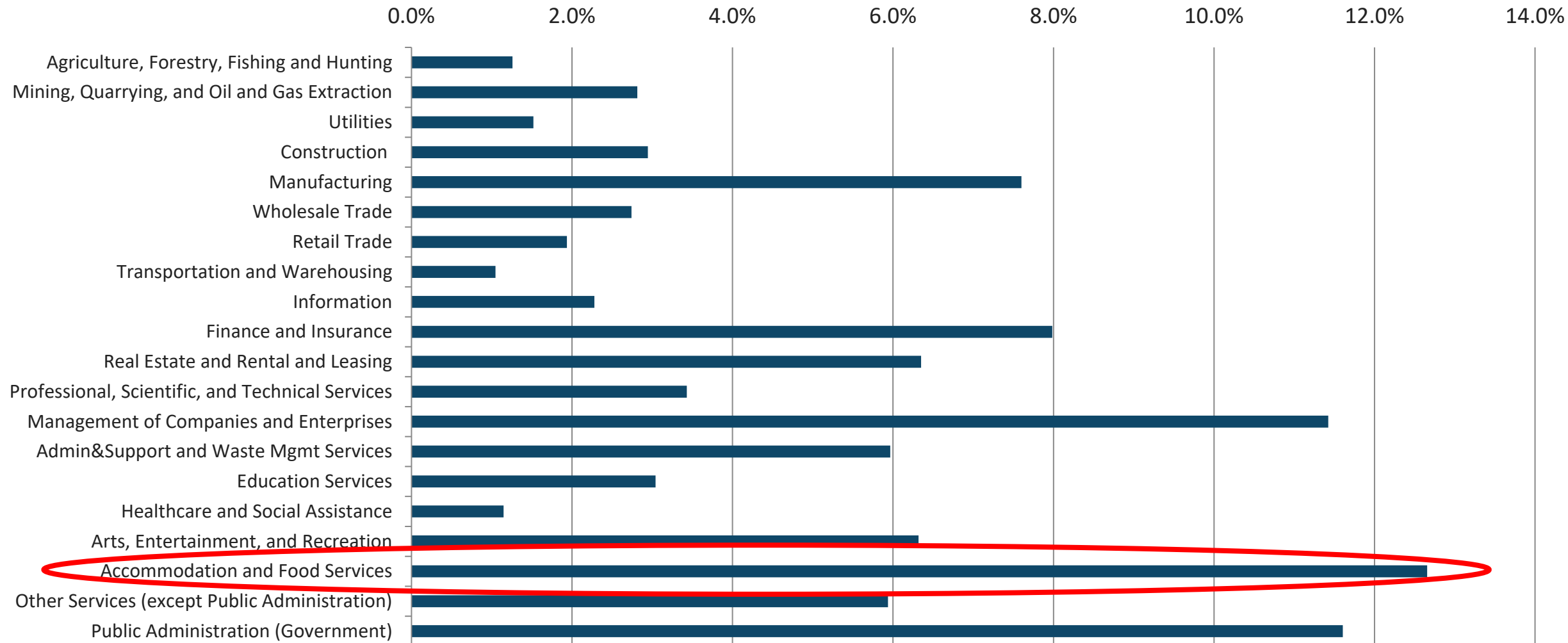
1. Hospitality
 - Non-work domestic traveler numbers are increasing
 - Conferences/group travel generally paused (again); Full-service hotels will continue to face headwinds
2. Retail
 - Too much space overall, especially in the B & C Mall space
 - Ecommerce sales continue to grow, creating headwinds for traditional retailers
 - Restaurant closures due to the pandemic have created headwinds and longer-term scarring
3. Office
 - Individuals and businesses were pivoting away from higher cost markets pre-COVID, and it is continuing
 - Pandemic accelerated work from home trends that have been showing up in the census data for last 10 years
 - Flexibility is highly valued by workers. Businesses value it because of non-monetary value.
4. Multifamily
 - Lack of new supply (lower-price product) led to robust rent increases and functionally full occupancy
 - Upper-price tier has reasonable vacancy rates due to more new deliveries.
 - 9 million renters are behind of rents

HOTELS



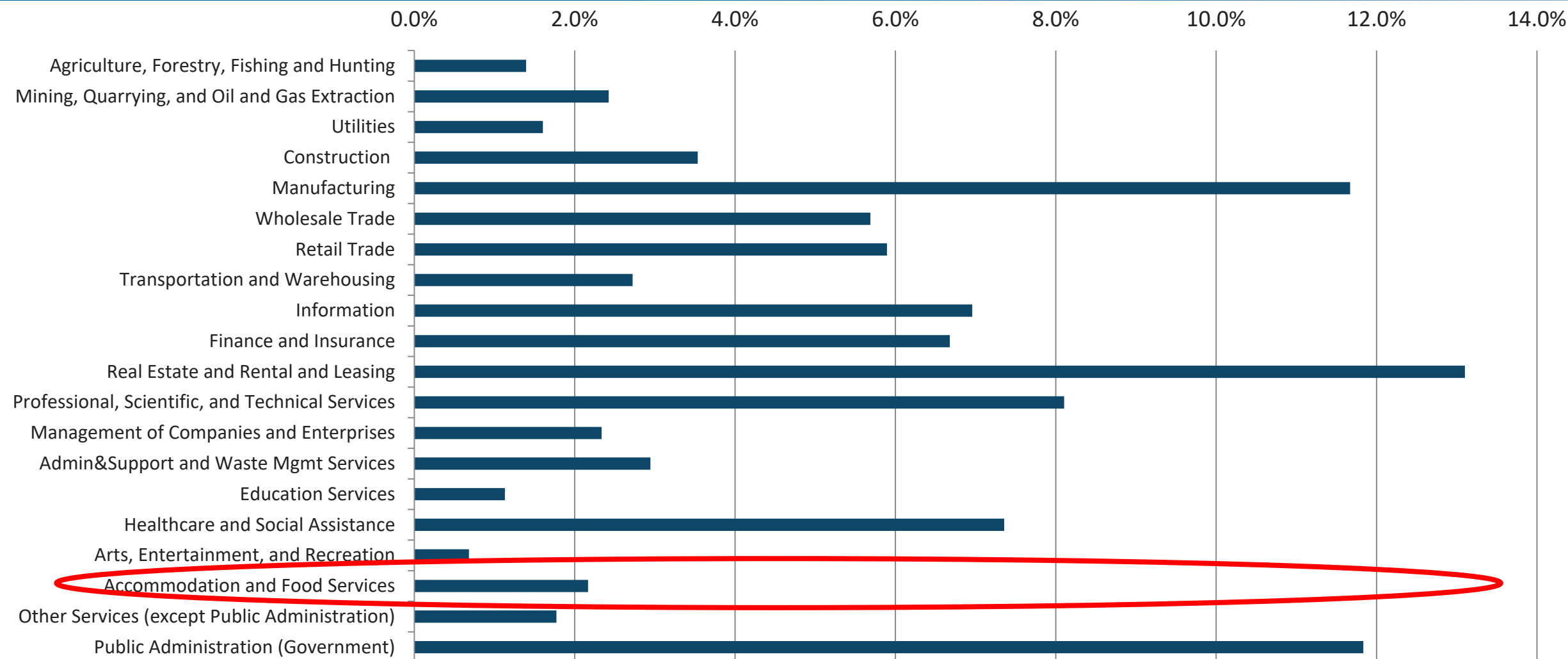
U.S. GDP Composition by Industry

2019 Annual Data



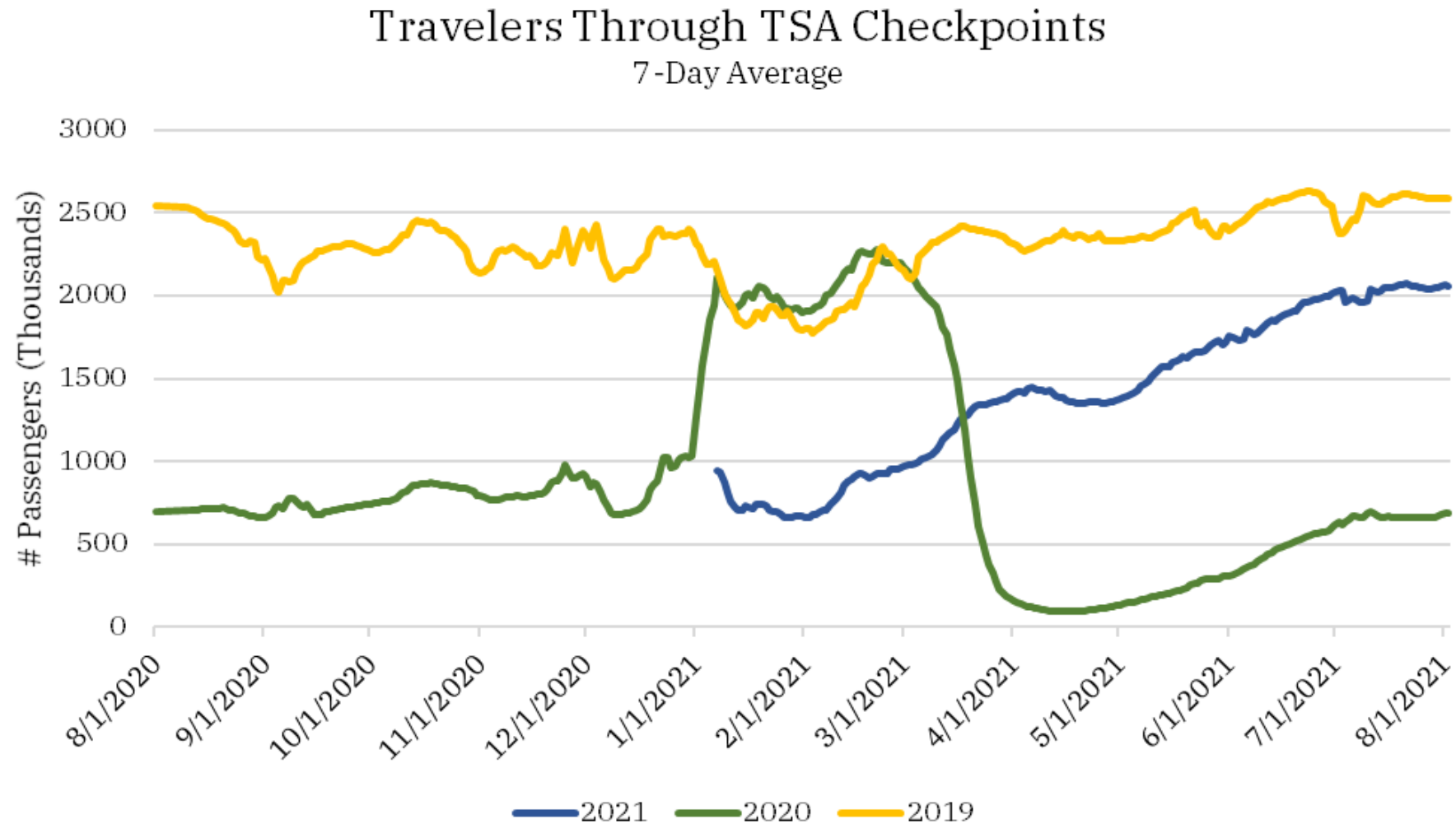
U.S. GDP Composition by Industry

2020 Annual Data

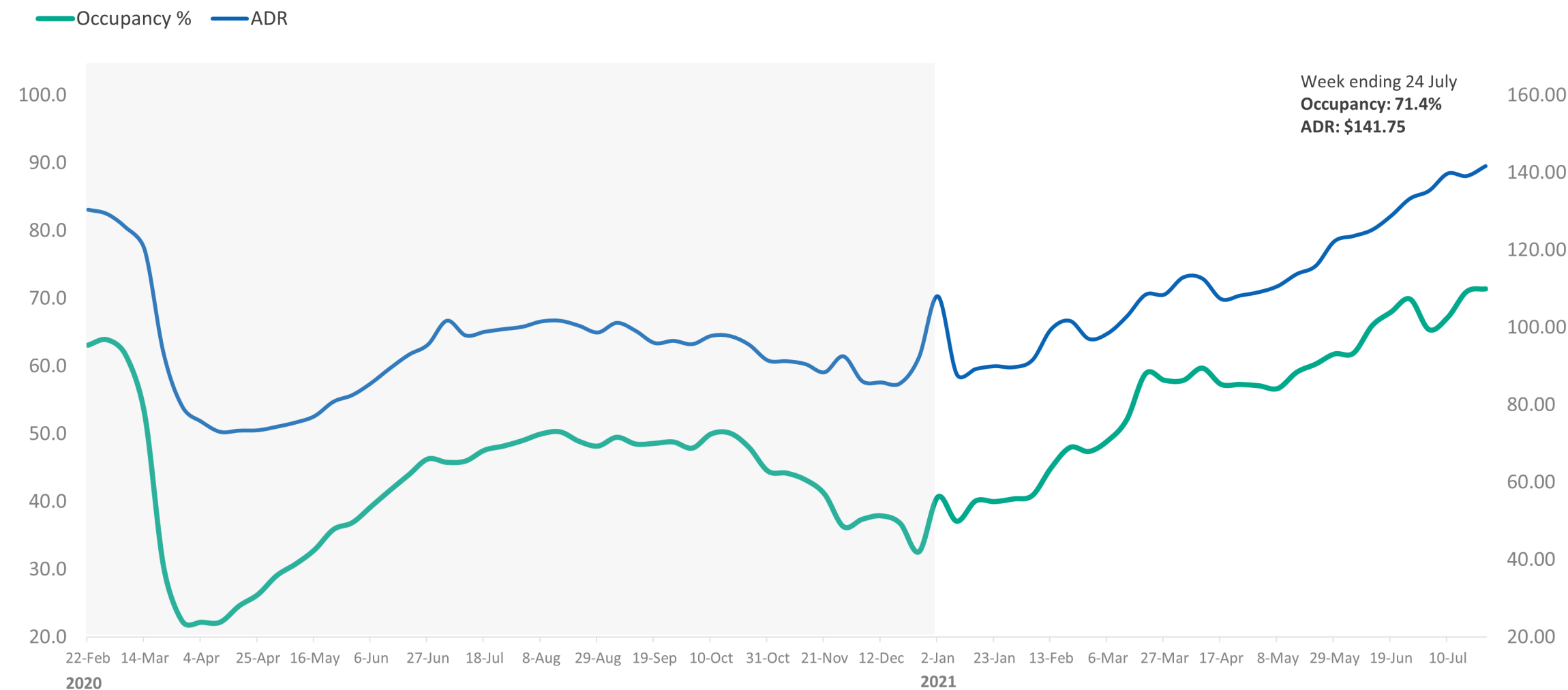


Sources: Bureau of Economic Analysis; Haver Analytics; Staff Calculations

Travel is Rebounding



Hotel Occupancy and Average Daily Rates



Source: STR, 2021 © Costar Realty Information, Inc.

RETAIL

A black rectangular sign with a white border is hanging from a metal ring. The sign features the word 'Sorry' in a white cursive script, 'WE'RE' in white uppercase sans-serif font, and 'CLOSED' in large, bold, yellow uppercase sans-serif font. The sign is positioned in front of a glass door. To the right, a red sign with white text is partially visible, showing the letters 'Con' and a large '0'. The background is dark and out of focus.

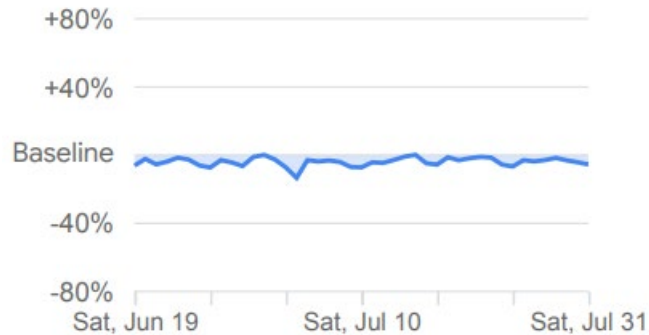
Sorry WE'RE
CLOSED

Mobility Near Retail Locations

Retail & recreation

-5%

compared to baseline

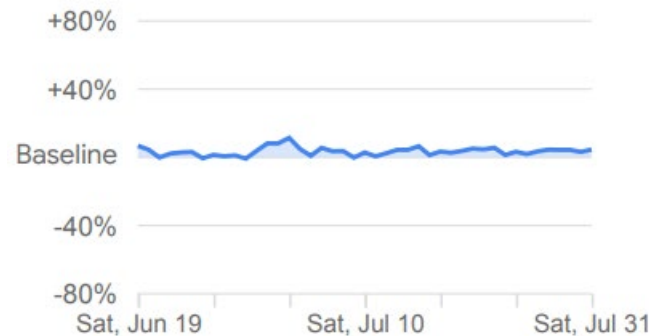


Mobility trends for places like restaurants, cafes, shopping centers, theme parks, museums, libraries, and movie theaters.

Grocery & pharmacy

+5%

compared to baseline



Mobility trends for places like grocery markets, food warehouses, farmers markets, specialty food shops, drug stores, and pharmacies.

Parks

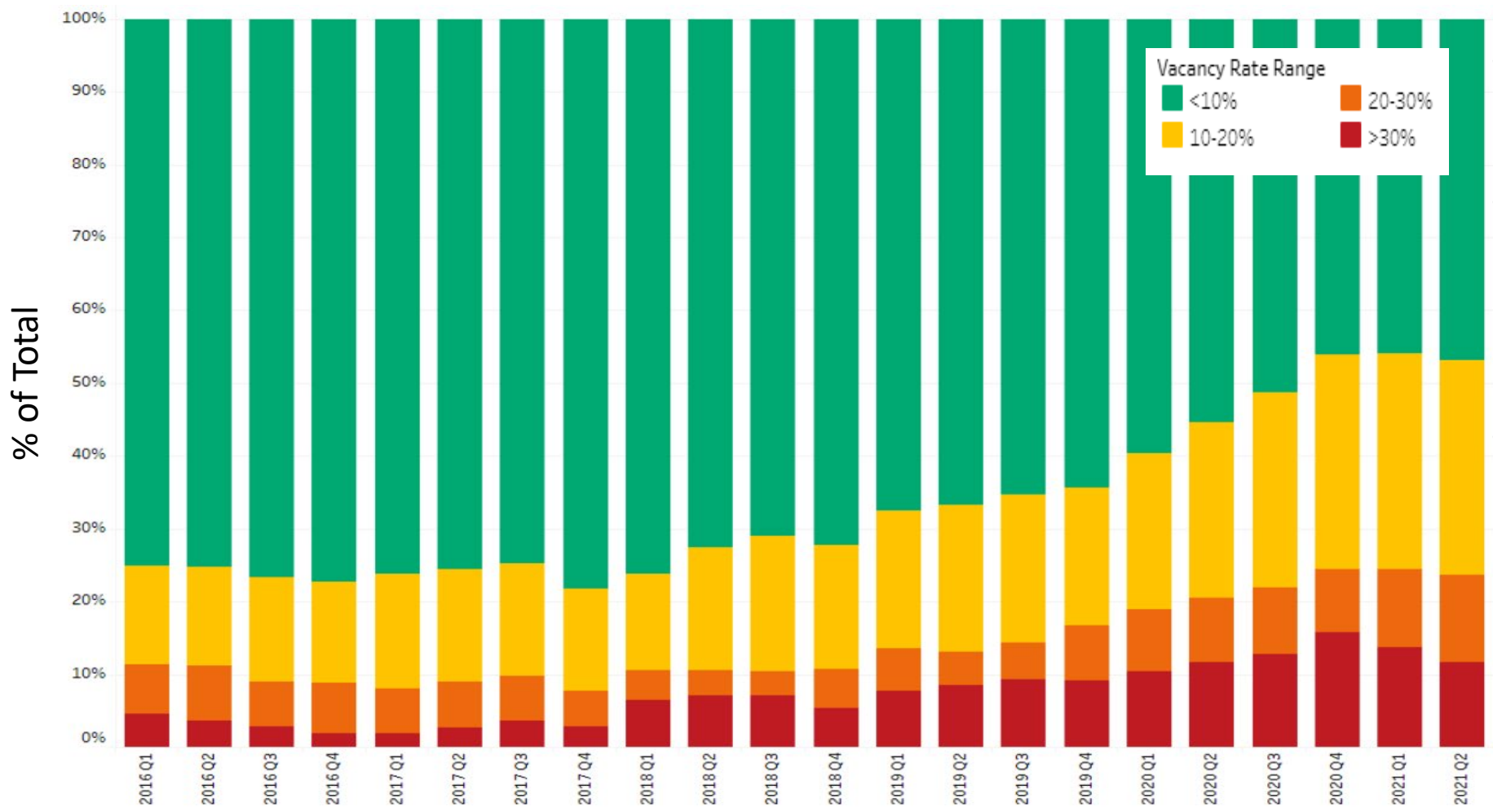
+65%

compared to baseline



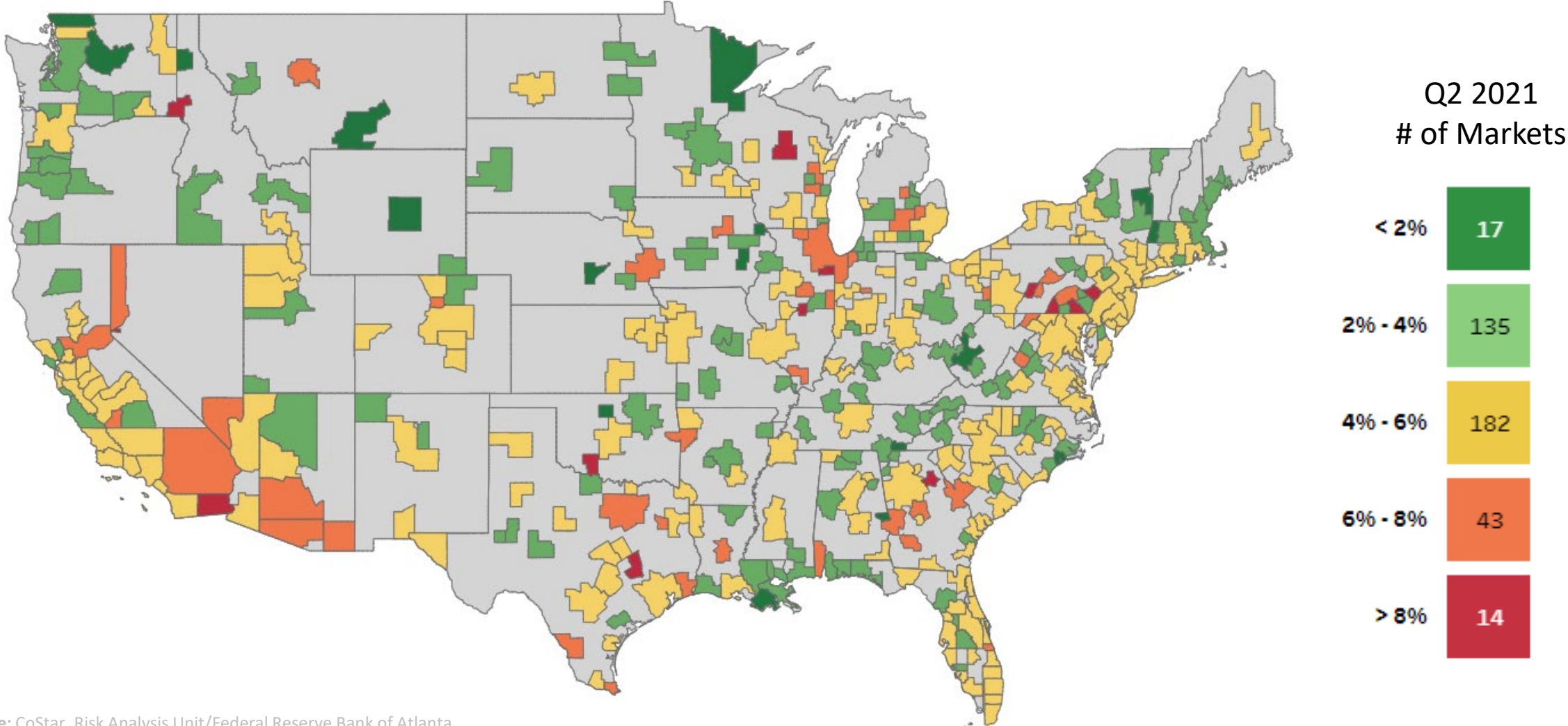
Mobility trends for places like national parks, public beaches, marinas, dog parks, plazas, and public gardens.

Mall Vacancy Rates



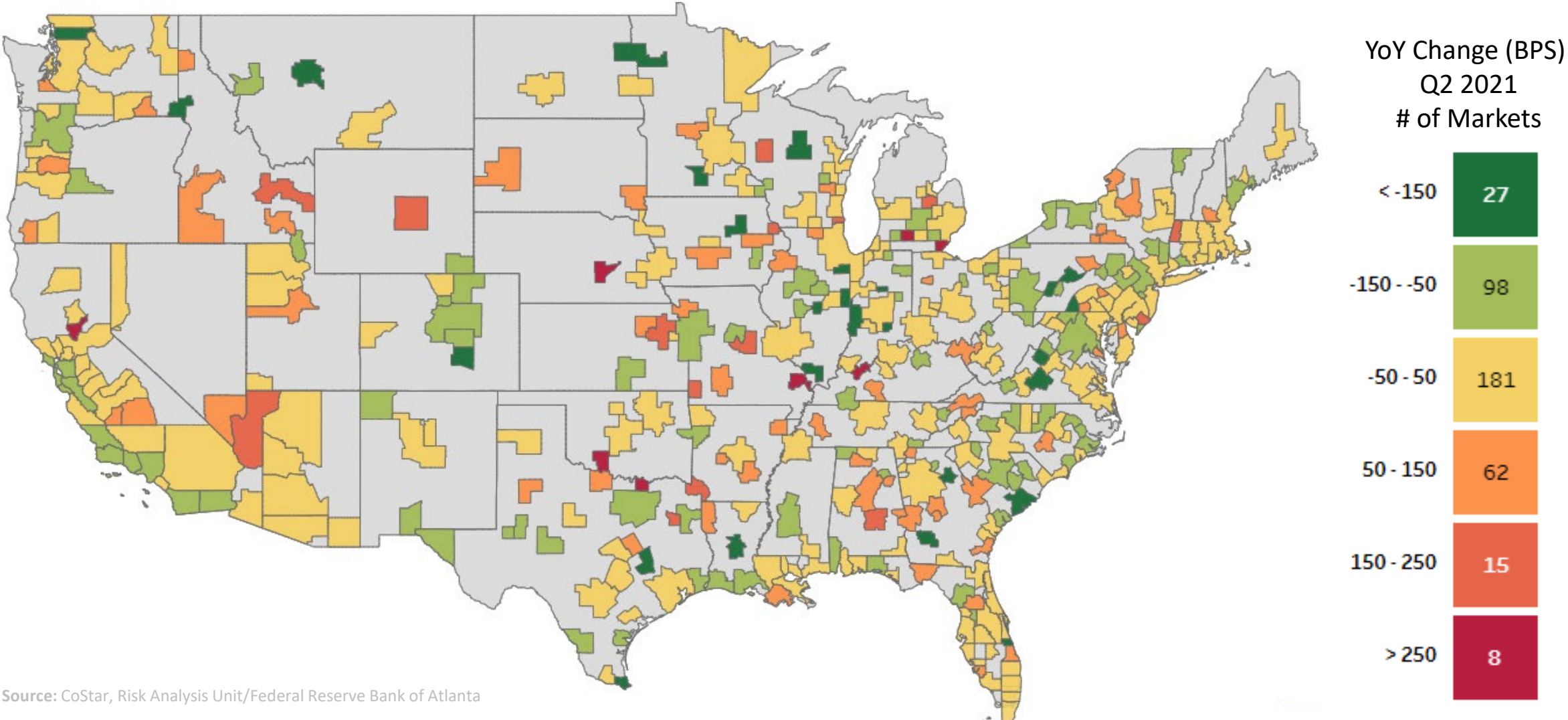
- Sellers of goods continue to face significant headwinds
- COVID-19 accelerated stress at malls as the overall percentage of malls with high vacancy rates increased
- Malls with vacancy rates >30%, have increased more than 3X since 2016

Retail Vacancy Rates



Source: CoStar, Risk Analysis Unit/Federal Reserve Bank of Atlanta

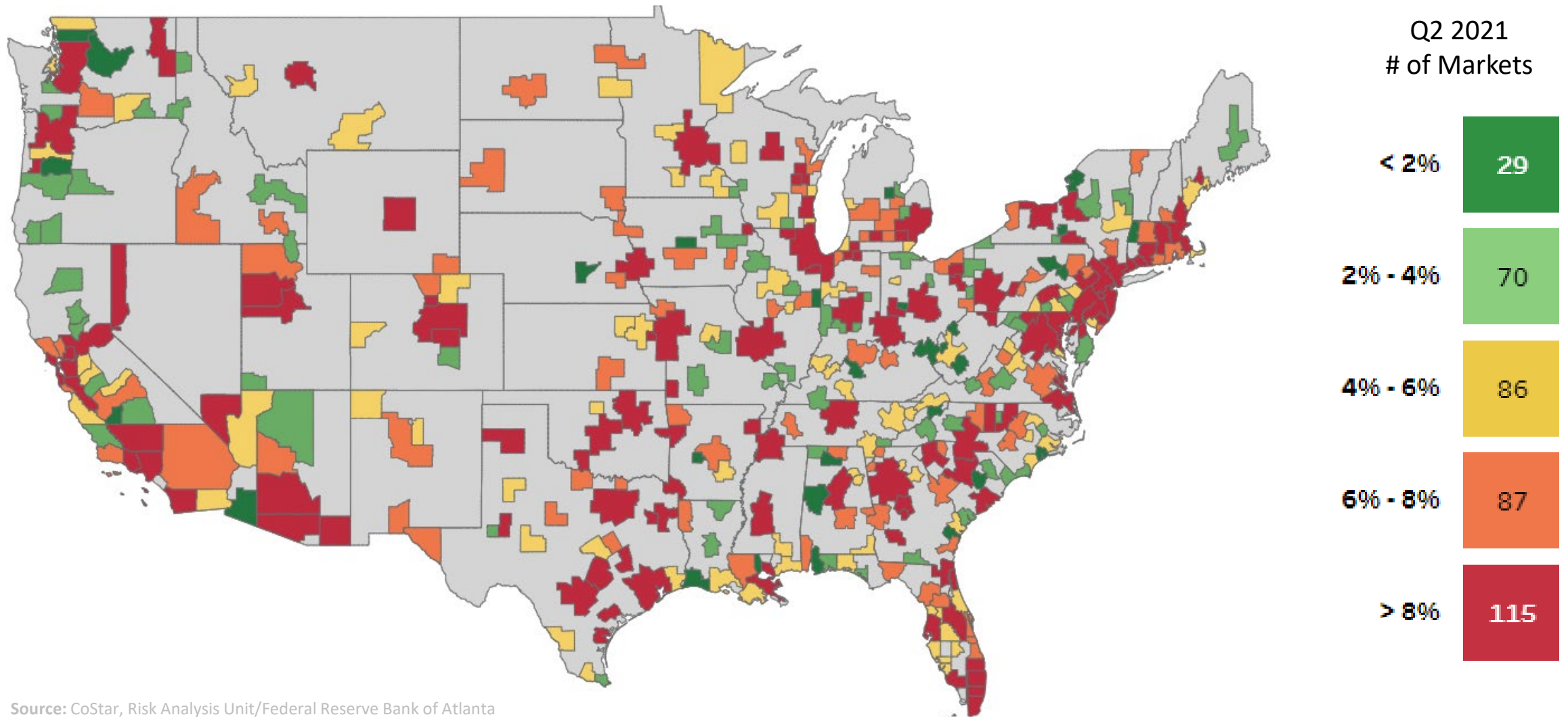
Change in Retail Vacancy Rates



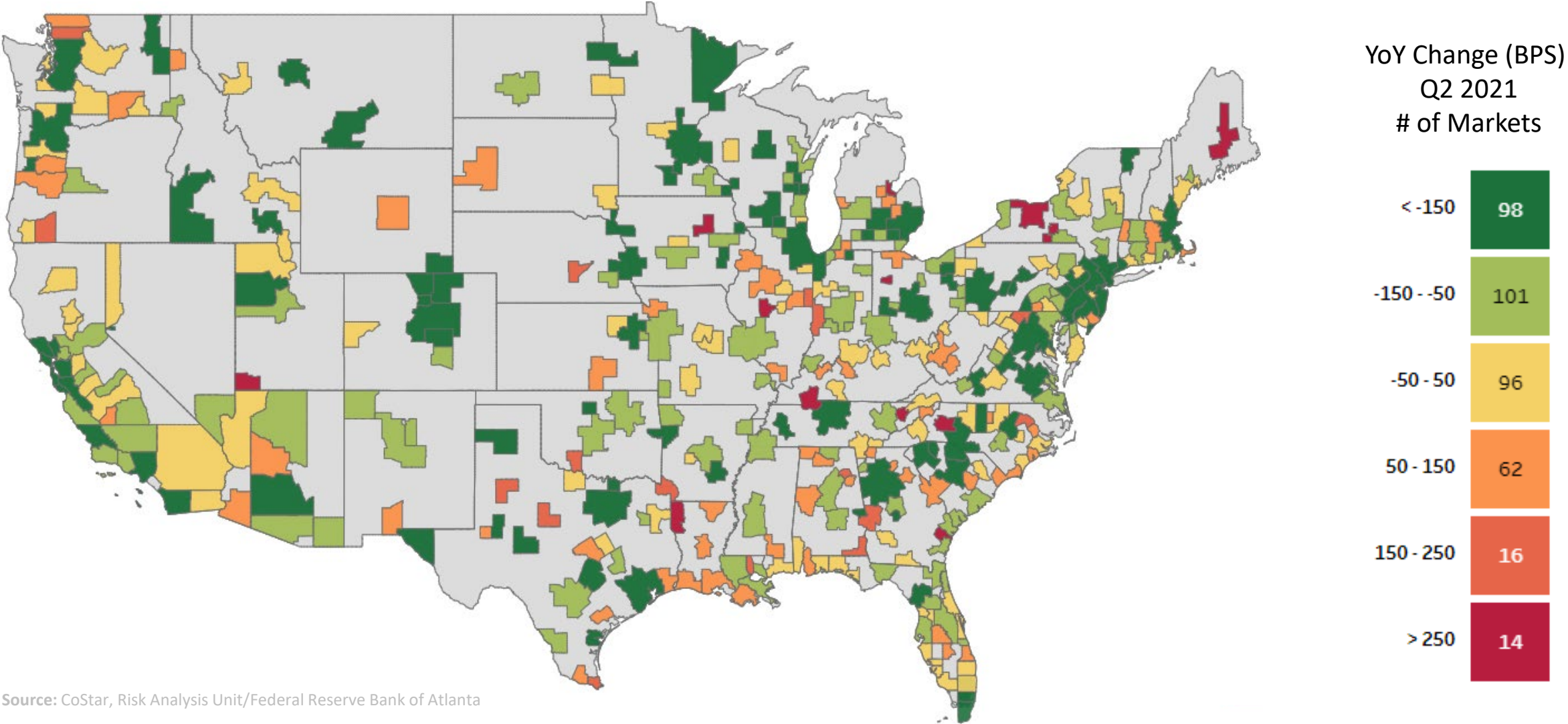


OFFICE

Office Vacancy Rates

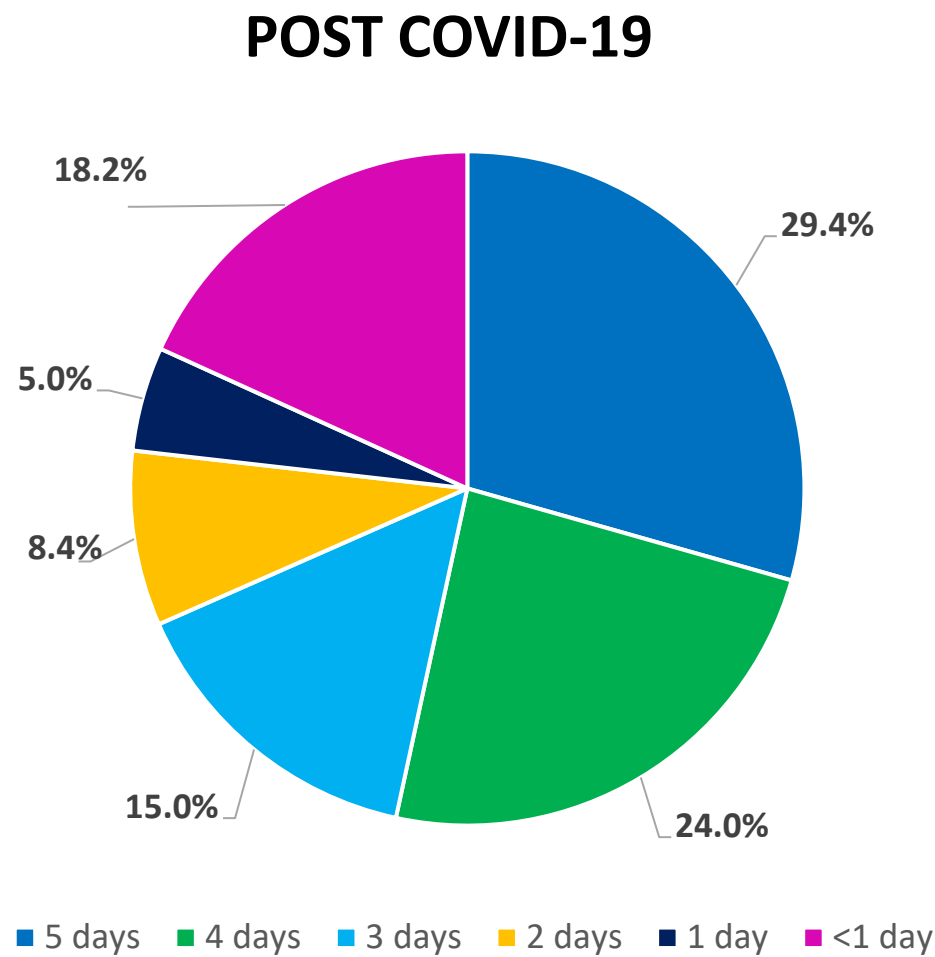
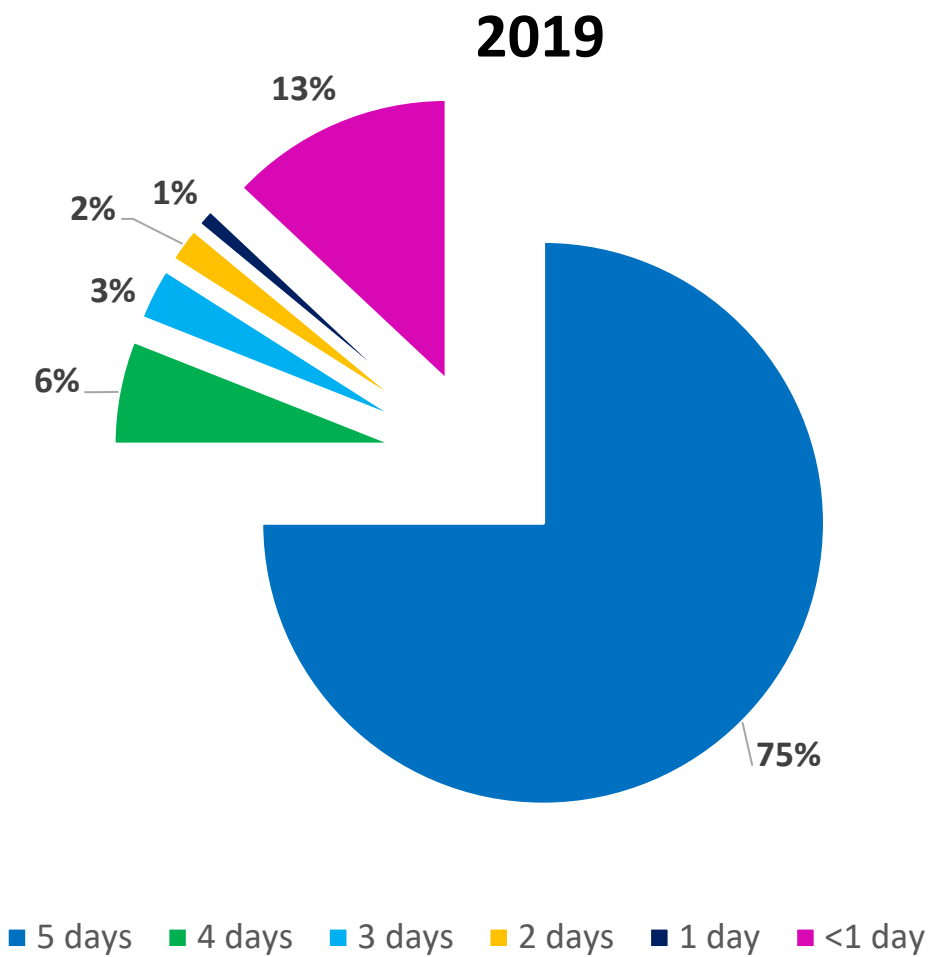


Change in Office Vacancy Rates

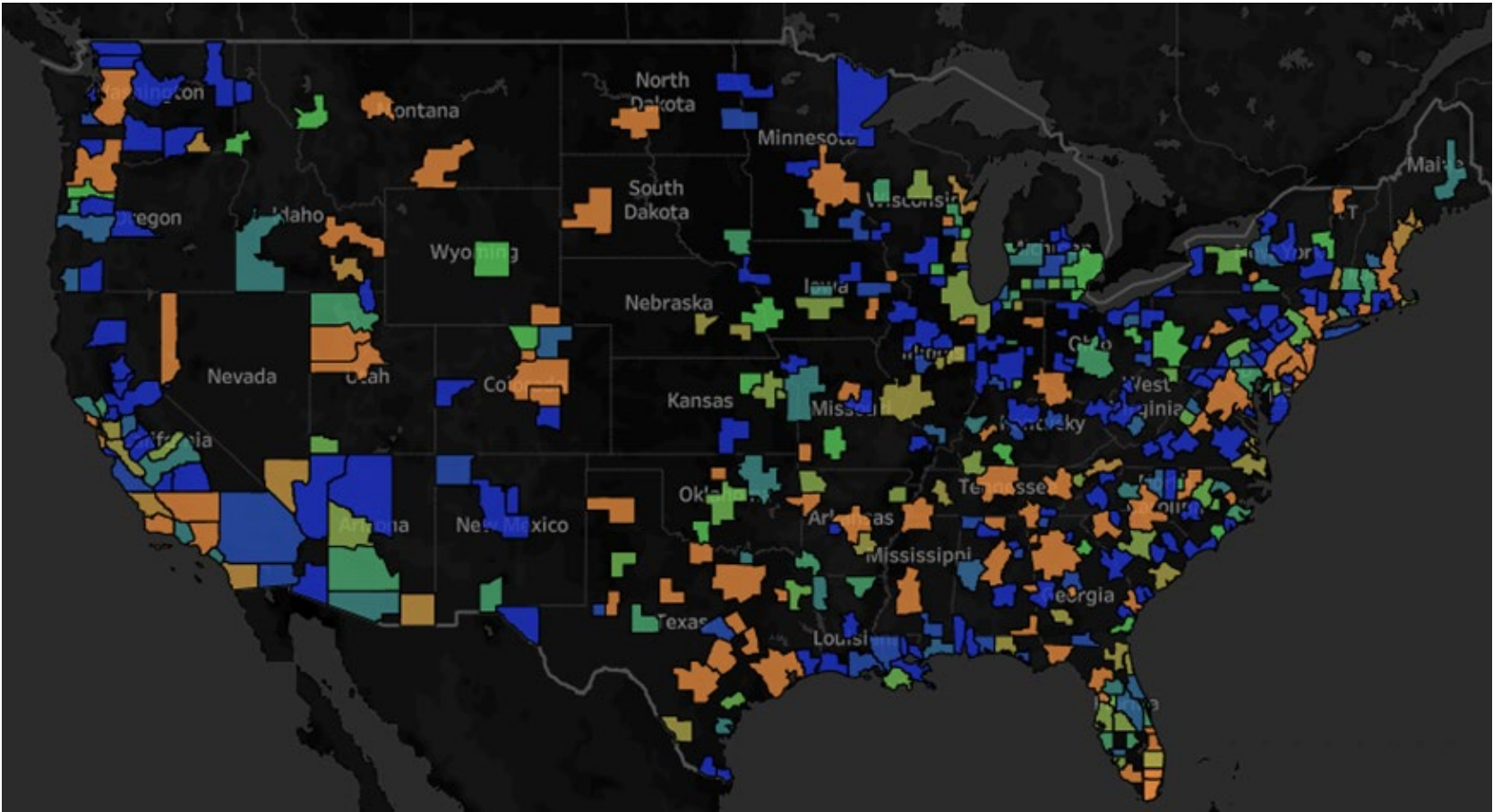


Future Work From Home?

Percentage of workers working in the office by number of day(s)



CRE Momentum Index - Office



Downward Trending
Momentum



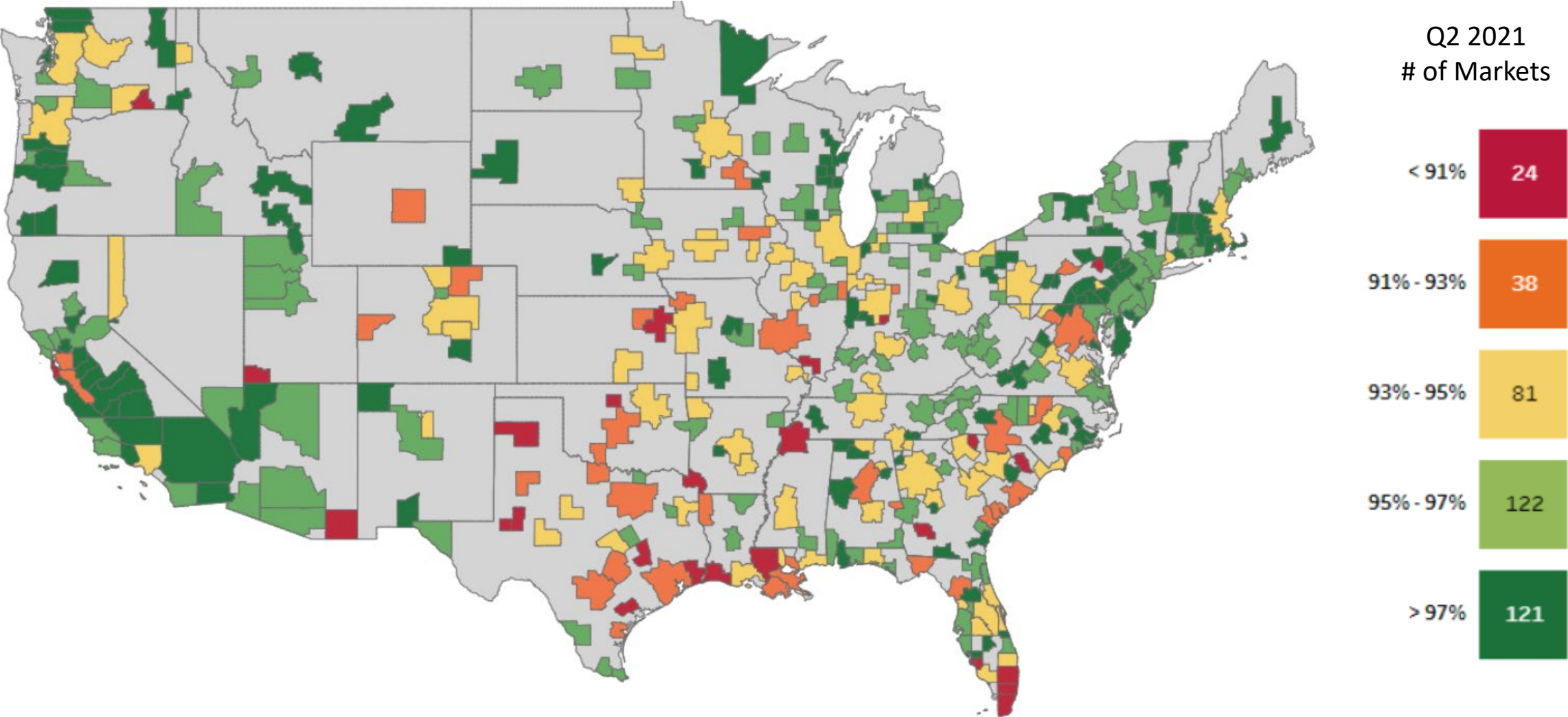
Upward Trending
Momentum

Source: Risk Analysis Unit/Federal Reserve Bank of Atlanta

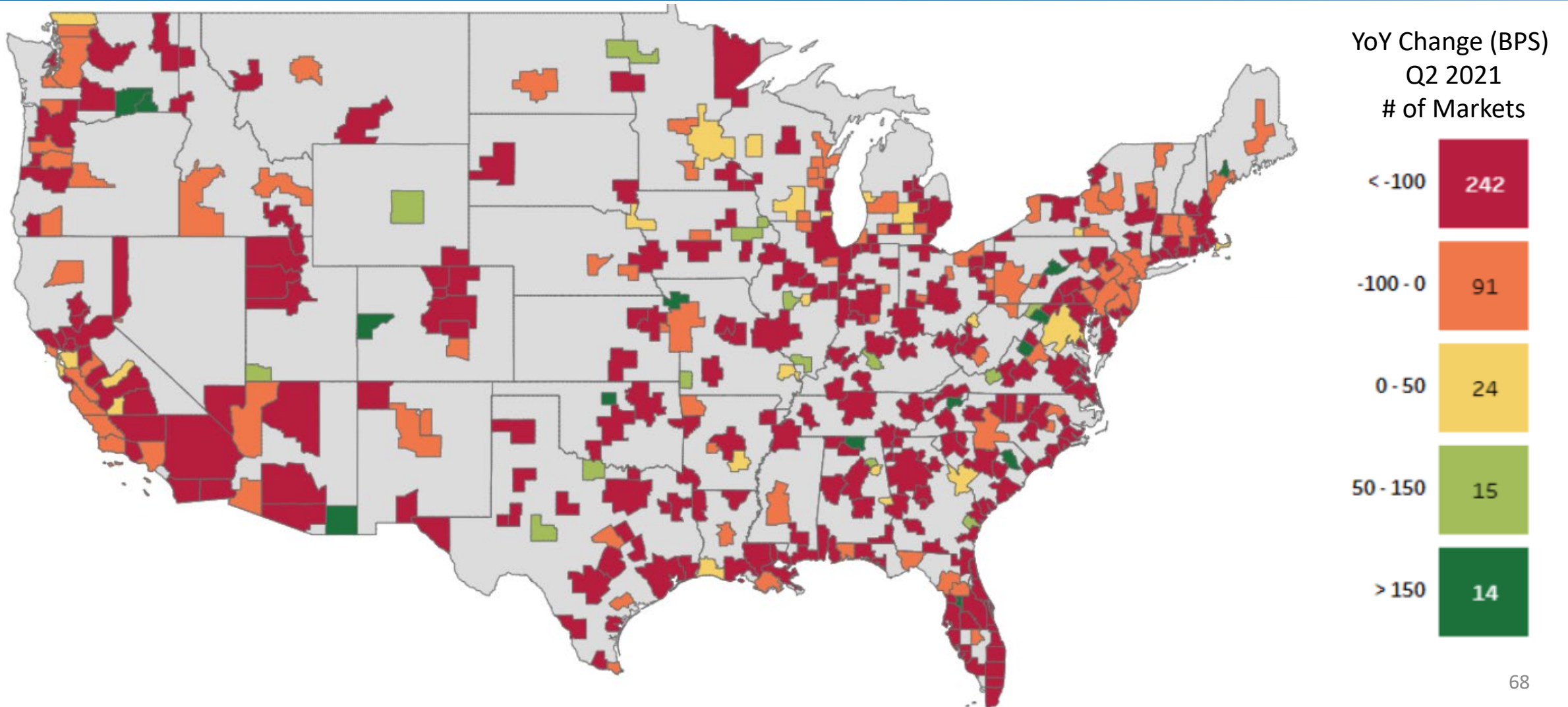
MULTIFAMILY



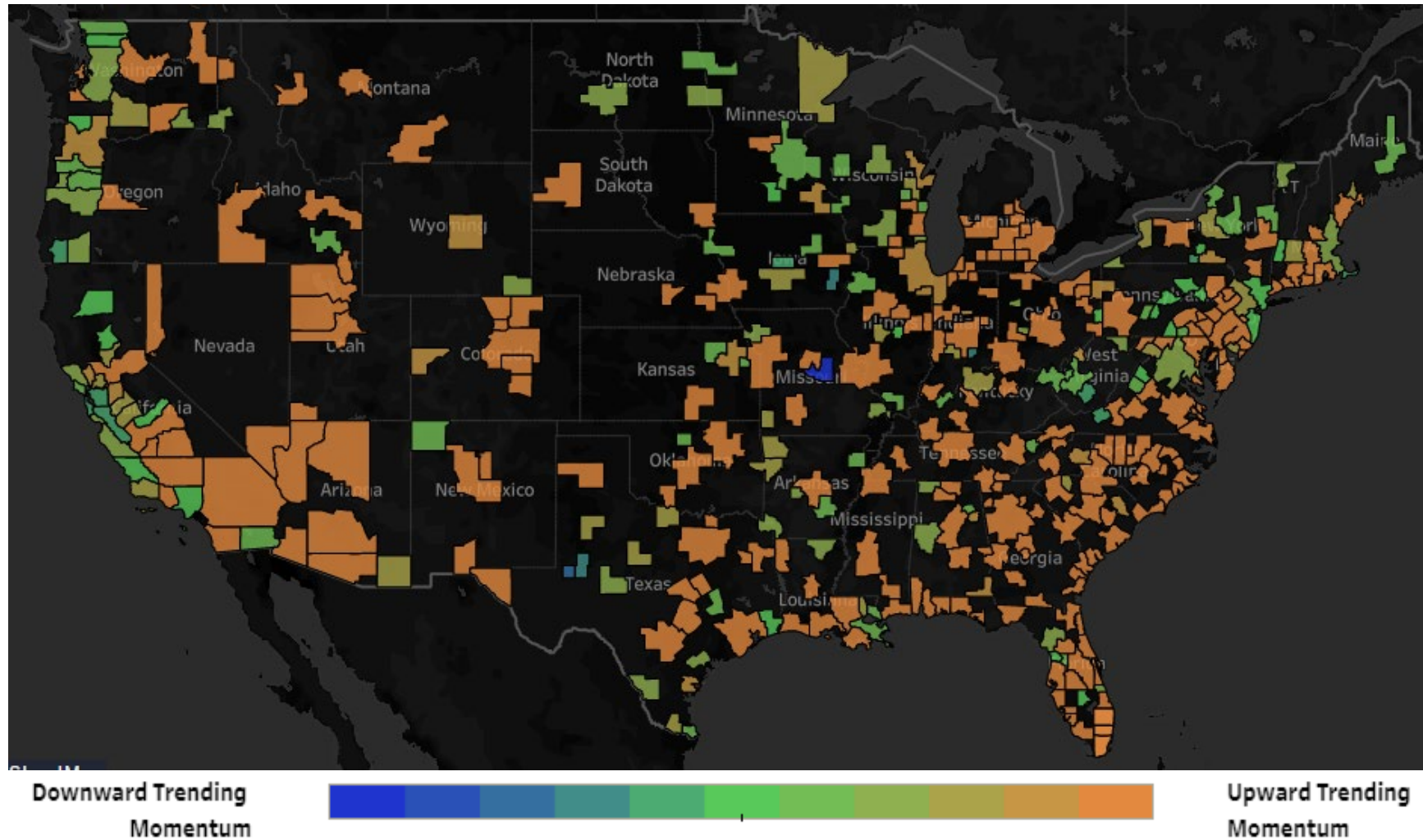
Multifamily Occupancy Rates



Change in Multifamily Occupancy Rates



CRE Momentum Index – Multifamily Rent Growth

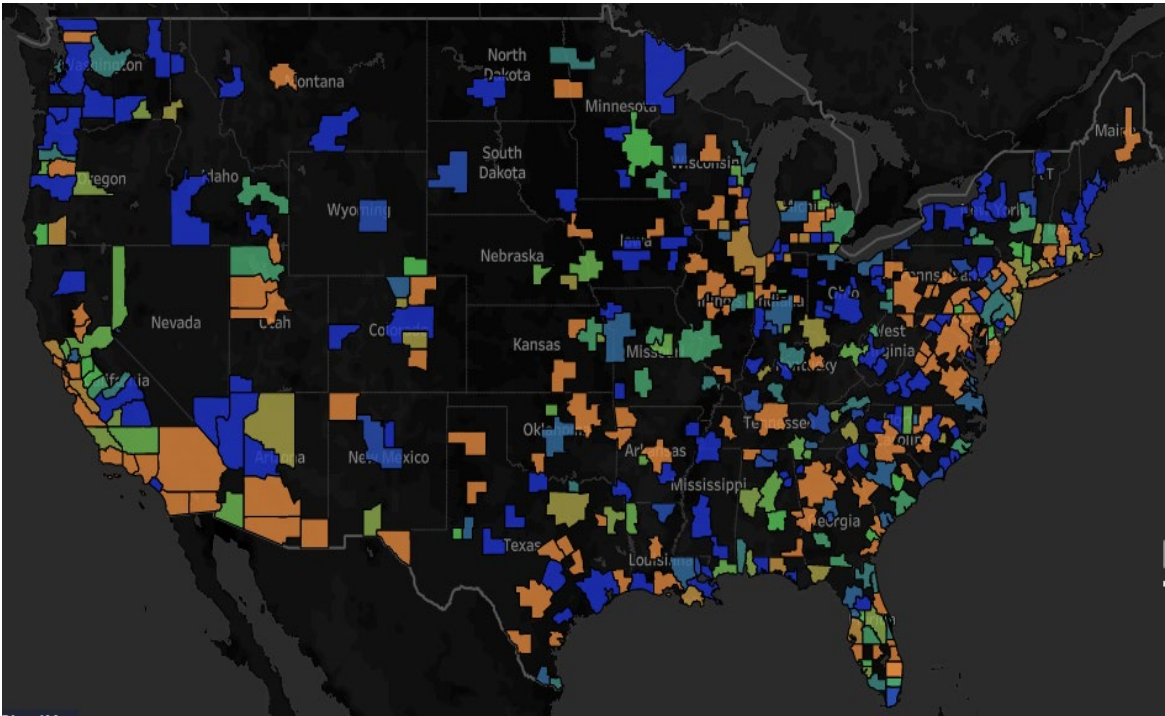


CRE Momentum Index

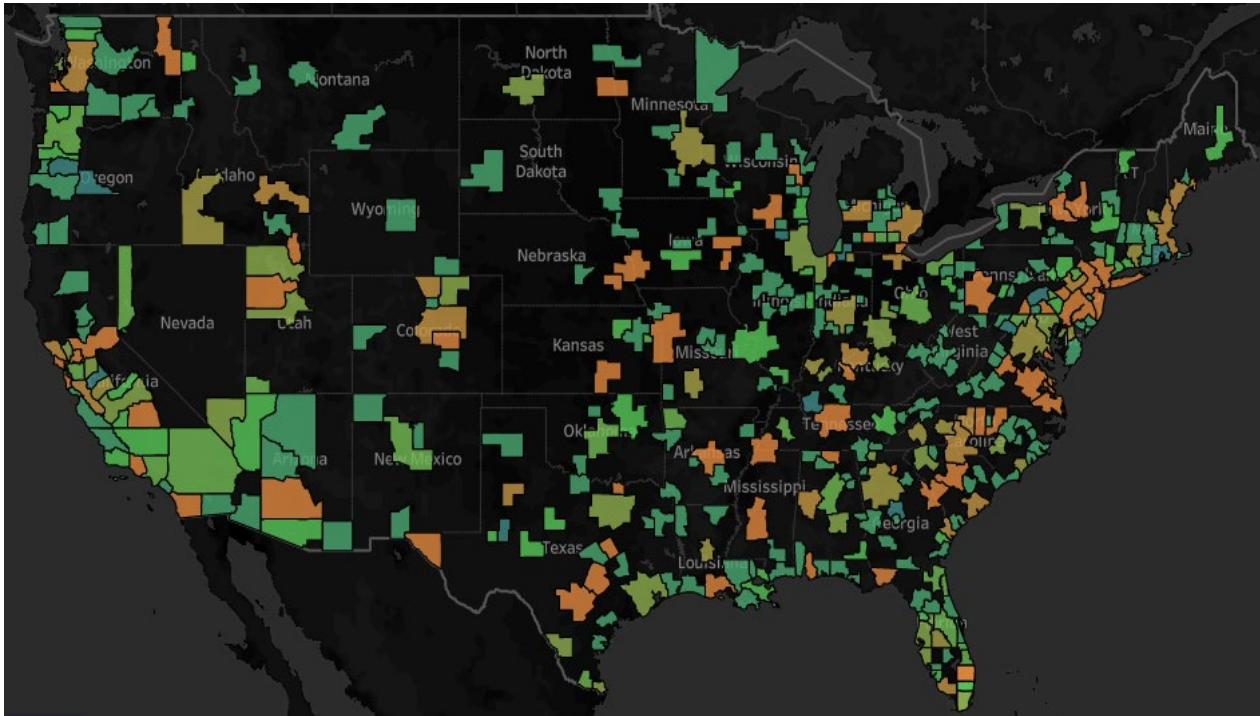
Where can it be found:
ATLANTAFED.org

See Data and Tools Tab
Or
Search: Commercial Real Estate
Momentum Index

Retail



Industrial – Construction Forecast



Downward Trending
Momentum



Upward Trending
Momentum

Final Remarks

1. Employment activity has improved since the early stages of COVID; unemployment continues to decline, though labor force participation lags.
2. The Hotel and Retail Sectors have faced the brunt of the loss of economic activity in the CRE space. Activity in both sectors is stalling.
3. As the economic circumstances and situation in CRE evolve, risk will also pivot.
4. The most sizeable fundamental risk is in the Office sector. It may continue to emerge in the short/mid-term as more employers right-size their office footprint.

Q&A Session

To ask a question – use the WebEx chat

Address your question to "all panelists"

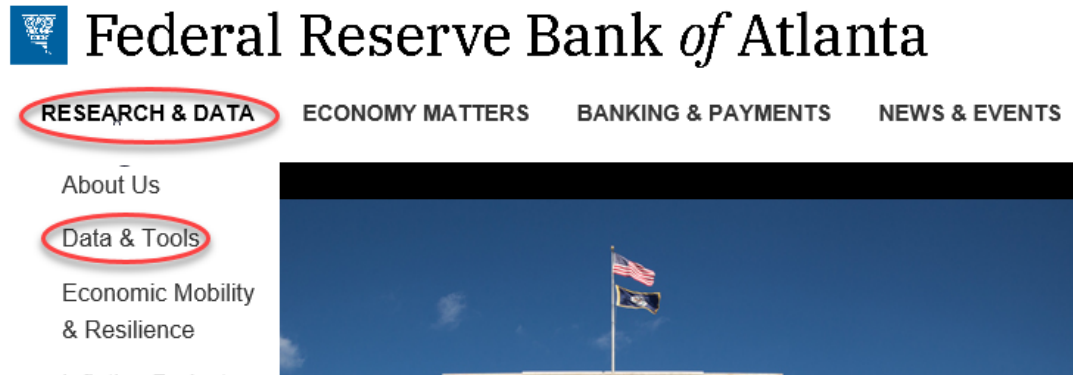


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Additional Information

CRE Supervisory Guidance and Other Resources

- [Commercial Real Estate \(CRE\) Momentum Index - Federal Reserve Bank of Atlanta \(atlantafed.org\)](https://atlantafed.org)



- [FRB: Supervisory Letter SR 07-1 on interagency guidance on Concentrations in Commercial Real Estate -- January 4, 2007 \(federalreserve.gov\)](https://federalreserve.gov)

Final Q&A Session

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SRC ViewPoint webinars - View the archives [HERE](#).

Other Helpful Links:

Community Banking Connections: www.communitybankingconnections.org

[Federal Reserve Supervision and Regulation Report](#) (bi-annual publication)

<https://www.federalreserve.gov/supervisionreg.htm> (Board of Governors S&R site)

<https://www.frbatlanta.org/banking-and-payments/supervision-and-regulation.aspx> (FRB Atlanta S&R site)

Today's Survey

Thank you for joining us today.

Save The Date(s): **September 27th and October 5th** – two-part panelist roundtables: *Ask The Fed “A Conversation on Service Provider Partnerships”* featuring community bankers and service providers.

October 20th – FRB Atlanta CRE Webinar with Brian Bailey

When you exit from WebEx, today's survey will appear. Please take 3-4 minutes and complete our survey, tell us what you liked, where we can improve, and what you would like to see in the future.