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Need a Loan Modification? ASK! - Guidance on the CARES Act and Banking

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The Coronavirus Aid, Relief, and Economic Security Act or the "CARES Act" along with recent guidance from bank regulators have increased the flexibility banks can offer to borrowers and created new opportunities for lending. In short, banks are better positioned to help their customers through the economic hardships that accompany the COVID-19 pandemic. Consider contacting your bank to discuss temporary loan modifications or a new loan. Also, if you find yourself negotiating with a landlord or other creditor that needs your payment to meet a loan obligation, consider asking them to seek a modification of the loan that's forcing them to demand payment from you. Specifics are discussed below. Under the right circumstances payment deferments, skips for existing loans, and new loans are available. I am finding banks eager to help if asked.

The CARES Act establishes the Paycheck Protection Program, which expands the existing Small Business Administration 7(a) loan program to include forgivable loans. That program is covered in detail in an article by my colleague Lauren Deyo: The CARES Act's Paycheck Protection Program Expands the SBA 7(a) Loan Program, which addresses eligibility for these loans, and subsequent forgiveness of these loans. Even if your business is not a good candidate or if you are not interested, consider sharing information about the loans with business partners, such as your tenants and customers. Having cash available to the people with whom you do business is likely good for your business.

For loans more generally, the CARES Act changes the community bank leverage ratio to create greater opportunities for community banks to make loans. The Economic Growth, Regulatory Relief, and Consumer Protection Act passed by Congress in May 2018 originally directed federal regulators to establish a leverage ratio for community banks of between 8% and 10%. Community banks were generally defined as banks with assets of less than $10 billion, and the leverage ratio is generally Tier 1 capital (basically shareholder equity and retained

earnings)/average consolidated assets (an amount that includes loans due to the bank). Federal regulators selected 9% as the leverage ratio. The CARES Act drops the number to 8%. While this decrease may not seem an important change, for context, the 1% decrease gives a community bank with $5 billion in Tier 1 capital an additional $50million in new lending capacity.

The CARES Act also addresses banks' measurement of expected credit losses and the creation of reserves for those losses. In 2016, the Financial Accounting Standards Board proposed a new manner for determining likely credit losses: "current expected credit losses," generally shortened to "CECL." Federal banking regulators proposed having CECL replace the allowance for loan and lease losses or "ALLL" in use as a similar regulatory requirement. Both CECL and ALLL require banks to determine likely losses and create reserves for those losses. Creating reserves depresses bank earnings as income is allocated to reserves intended to cover expected losses and, perhaps more importantly for this article, shifts funds away from retained earnings (Tier 1 capital) where the funds would otherwise increase the bank's ability to lend. Many in the banking industry viewed the change from ALLL to CECL as much more than a technical accounting change. There was particular concern that CECL would increase the reserves banks were required to maintain and decrease lending ability. In testimony before Congress on January 15, 2020, the American Bankers Association characterized the change as representing "a sea change to the banking industry" and warned that "CECL will reduce the availability of credit when it is needed the most – during an economic downturn."

The CARES Act suspends application of the CECL standard from the date of the Act until the crisis passes, but no later than December 31, 2020. The CECL suspension should mean banks are not required to increase reserves and may have more money to lend.

The CARES Act also gives banks meaningful flexibility for loan modifications. Historically troubled debt restructuring (often referred to by the acronym "TDR") rules have limited banks' ability to modify loans. Generally, restructuring a debt constitutes TDR if the bank, for economic or legal reasons related to the borrower's financial difficulties, grants a concession to the borrower it would not otherwise consider. Once a TDR occurs, the bank is required to set aside income from operations to fund a reserve (TDR and ALLL/CECL are closely related). Using funds for a reserve decreases a bank's earnings as funds are allocated to cover expected losses related to TDR and shifts funds from retained earnings (Tier 1 capital) where the funds would increase lending capacity, thereby limiting the amount the bank can lend. In short, a TDR is often a bank's last resort.

The CARES Act gives banks the ability to modify interest rates and repayment terms of loans without triggering TDR provisions, so long as the loan is not more than 30 days past due (as of December 31, 2019) and the borrower's adverse circumstances are related to COVID-19. The CARES Act takes the further step of directing regulators to be deferential to banks' determination about suspending TDR rules, giving banks some comfort that regulators will not second-guess a banker's decision.

Bank regulators have issued guidance consistent with the flexibility in the CARES Act. In a FAQ bulletin issued March 27, 2020, the FDIC said:

"The FDIC encourages financial institutions to provide borrowers affected in a variety of ways by the COVID-19 outbreak with payment accommodations that facilitate their ability to work through the immediate impact of the virus."

The FDIC specifically mentioned skipping and deferring payments as examples of payment accommodations it would support. Similarly, in a bulletin issued March 13, 2020, the Office of the Comptroller of the Currency said:

"The OCC encourages banks to work with affected customers and communities. The OCC recognizes that such efforts 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. These efforts may include . . . offering payment accommodations, such as allowing borrowers to defer or skip some payments or extending the payment due date."

In joint action on March 27, 2020 the OCC, Federal Reserve, and FDIC delayed implementation of CECL by two years. This delay furthers the benefit of the CARES Act and eliminates any angst that might otherwise have arisen later in 2020 as the CARES Act extension of CECL began to expire. The agencies said they "are providing this relief to allow such banking organizations to better focus on supporting lending to creditworthy households and businesses in light of recent strains on the U.S. economy as a result of the coronavirus disease." This is one more statement from regulators that they want banks making loans to help the economy.

Your bank now has congressional and regulatory flexibility to modify your loan without substantial risk of negative impacts it would normally face when modifying a loan. It's important to request a modification if you need one. Also, banks likely have more money to lend, not only in the new SBA Paycheck Protection Program, but for other loans too. If you need more credit to survive the pandemic, ask.

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