AMERICAN BANKER®

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Climate change advice

Banking and other financial industry regulators should take these steps to minimize the systemic threat posed by changing environmental conditions and natural disasters, a CFTC subcommittee recommends

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Promote industry sharing of best practices

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The only rational strategy for holding mortgage servicing rights is to be very aggressive on protecting the servicing assets via loan recapture. This is one of the chief reasons that banks have been willing to give up their share in lending and servicing as they collapse back to retail-only lending strategies, Christopher Whalen writes. **Page 9**

LOAN MODIFICATIONS

Bankers urge extension of CARES Act reg relief

By Neil Haggerty
September 18, 2020

WASHINGTON — At the beginning of the coronavirus pandemic, Congress gave banks and credit unions relief from a number of regulations so that they would have flexibility to help commercial and retail customers weather the economic shock.

Those regulatory relief measures are set to expire Dec. 31, but with the virus still raging and many households and businesses still struggling, financial institutions are urging Congress and regulators to extend them into next year. And while it is unclear if regulators will act on their own to extend the relief, lawmakers from both parties have expressed support for continued pandemic relief.

Among other things, the Coronavirus Aid, Relief, and Economic Security Act relieved financial institutions from having to categorize loan modifications related to the pandemic as troubled debt restructurings until the end of 2020, and it it enabled them to delay compliance with the Financial Accounting Standards Board's Current Expected Credit Losses standard until the end of the year. The legislation also eased community banks' capital requirements by lowering the Community Bank Leverage Ration from 9% to 8% until 2021, and it authorized the Federal Deposit Insurance Corp. to revive its crisis-era program backstopping bank-issued debt and noninterest-bearing transaction deposits that exceed the FDIC's $250,000 limit.

Troubled debt restructurings have been of particular concern for banks as they anticipate that their customers could need loan modifications long after the CARES Act relief expires.

Critics of troubled debt restructurings have argued that they reduce the incentive for banks to work out new loan agreements with struggling borrowers, since they require banks to set aside more in capital reserves and they create other administrative hassles. The American Bankers Association is asking that the exemption on troubled debt restructurings remain in place at least until January 2023 while the Independent Community Bankers of America asked Congress in a September letter to extend the relief until the end of 2021.

"We requested [an extension]...in large part because there will be debt restructurings and we don't want the regulatory agencies in retrospect to look negatively at institutions and what they have done to help their customers through a difficult time," said James Ballentine, executive vice president for political affairs and congressional relations at the American Bankers Association.

Paul Merski, group executive vice president for congressional relations and strategy at the Independent Community Bankers of America, said that banks are worried that they will be penalized by their examiners if they change borrowers' loan terms after the relief expires.

"Borrowers who are experiencing financial difficulty, banks can extend out the terms of the loan. … Really the regulators don't like that," Merski said. "That can be negative for your exam, for your bank for providing that kind of relief. It's still better than canceling or foreclosing on a borrower."

Jeff Naimon, a partner at Buckley, said bankers would likely be limited in their ability to assist borrowers if the troubled debt restructuring relief isn't extended.

"The path of the virus is unpredictable, and it's possible that the economy could roar back to life and then get crushed all over again by another wave," Naimon said. "You can imagine borrowers who could be in and out of trouble and institutions will have less flexibility and fewer options if the loan is already considered a TDR."

The CARES Act also allowed borrowers of federally-backed mortgages to request up to 12 months of forbearance if they have encountered financial hardship because of COVID-19. Naimon said that many banks could be in a crunch to get borrowers who received forbearance into loan modifications before the troubled debt restructuring relief expires.

"The bank would like the modification to occur within the period specified in the guidance, but it's also good for the consumer that their modified loan isn't considered a TDR because it preserves options for them down the line," Naimon said

Bankers are also pushing to further dealy CECL, which they decried even before the pandemic. Even some lawmakers have suggested scrapping the standard altogether.

Publicly traded banks were required to begin compliance with the new accounting standard for loan losses at the beginning of 2020, but the CARES Act enabled them to delay compliance until 2021. Community banks, on the other hand, already had until 2023 to comply with CECL. ICBA has suggested that FASB could suspend implementation of CECL until 2025, while ABA has supported pushing back the compliance date for larger banks until 2023.

Ryan Donovan, the chief advocacy officer at the Credit Union National Association, said that financial institutions shouldn't have

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to worry about complying with a complex new accounting standard during a pandemic.

"We've had concerns about the impact of a new expected credit loss accounting standard on credit unions for several years," Donovan said. "You add a global pandemic and an economic crisis to the mix and you've really got a recipe for a disaster for lenders and borrowers alike. Right now is not the time to change how financial institutions, particularly community based financial institutions, model or forecast for expected credit loss."

Jill Castilla, the CEO of the $317 million-asset Citizens Bank of Edmond in Oklahoma, said that many small banks don't have the resources to devote to CECL because they are too busy working with customers affected by the pandemic.

"CECL requires substantial investment and data collection — as a small community bank activated to serve our community during this challenging time, no attention in 2020 has been available to allocate to this burdensome and expensive accounting change," said Jill Castilla, CEO of the $317 million-asset Citizens Bank of Edmond in Oklahoma. "The labor and costs associated with CECL result in no value to small banks."

Ballentine said that ABA has supported a uniform CECL compliance date for all banks.

"Since the community institutions have until 2023, which we are certainly supportive of, we would argue that the all institutions should have that extended until 2023," Ballentine said. "One of the concerns we have had about CECL all along is how do you account for it in the worst of times? It's simpler to do it in the best of times when everything is certainly clear. The future is as murky today as it may ever be. And that is one of the challenges with implementing CECL during this time."

Christine Klimek, a spokesperson for FASB, did not rule out the possibility of allowing banks to delay compliance with CECL further.

"The FASB, through our Post-Implementation Review process, continues to engage with stakeholders to monitor the effects of the pandemic on financial reporting to determine what, if any, actions we should take," Klimek said in an email to American Banker.

While support for extending CARES Act relief is industry-wide, Donovan said he is concerned that Congress has not agreed on any additional coronavirus relief legislation.

"I think our biggest obstacle on this frankly is how Congress is functioning right now," Donovan said. "Put this up or down on a vote, it would probably pass both chambers. We won't get that vote. That's just now how Congress operates right now."

But lawmakers have been receptive to concerns from banks and credit unions.

Senate Banking Committee Chairman Mike Crapo, R-Idaho, urged regulators in a July letter to allow banks to delay compliance with CECL until Jan. 1, 2023. And he suggested regulators extend the relief from troubled debt restructurings until Jan. 1, 2022.

At a virtual conference hosted by the National Association of Federally Insured Credit Unions, House Financial Services Committee Chairwoman Maxine Waters, D-Calif., said she understands financial institutions' worries about relief from troubled debt restructurings expiring.

"I understand the concerns that credit unions have expressed about troubled debt restructurings … and the need for Congress to consider extended CARES Act provisions to help credit unions provide forbearance to their customers, while meeting their liquidity needs into 2021 as this crisis drags on," Waters said Tuesday.

ECONOMY

Bank of America CEO says more stimulus needed to help last of recovery

By Bloomberg News
September 18, 2020

Bank of America Chief Executive Brian Moynihan called for another round of federal stimulus to help the U.S. reach a full economic recovery from the coronavirus pandemic.

"You're back up to where 95% of the economy is back," Moynihan said Friday in an interview with David Westin in advance of next week's Bloomberg Equality Summit, adding that more help is needed for restaurants, airlines, performing-arts venues and state and local governments so they can "cross that same bridge" as housing, health-care and other recovered industries. "We've got to help everybody else get across."

Moynihan said a year-over-year increase in consumer spending is a sign of the economy's resilience. U.S. retail sales rose 0.6% last month, following a 0.9% gain in July, the Commerce Department reported earlier this week.

Government support for small businesses is running dry with the Paycheck Protection Program having closed in early August, and a supplemental $600 a week in unemployment benefits having expired at the end of July. Some House Democrats are keeping pressure on Speaker Nancy Pelosi to bring a new coronavirus relief bill up for a vote next week as they look to signal that the party is pursuing a deal to bolster the economy. Pelosi has held firm that the White House should first agree on a $2.2 trillion plan Democrats have put on the table.

A "second bite at the apple" for PPP would help the economy come back fully, Moynihan said.

"The idea of it recovering that last five percentage points tomorrow morning — it's going to take a while to grind through that," he said, adding that more government support would help industries still struggling. "What we need, I think, is pretty straightforward: You need more stimulus for the people."

ESG

Pressure mounts on U.S. bank regulators to stress test for climate change

By Laura Alix
September 20, 2020

Regulators need to give banks a kick in the pants to confront business risks posed by climate change, according to a new report out of the Commodity Futures Trading Commission.

Federal agencies — and banks themselves — should conduct stress tests and other analyses

that measure the financial industry's resilience to hurricanes, wildfires, floods and other natural disasters. Otherwise the economy could be subjected to shocks as devastating as the fallout from the coronavirus pandemic, the report said.

If the recommendations were to be adopted, banks in the short term would need to collect more and different kinds of data on their customers. In the longer term, lenders would have to make some tough decisions with respect to credit and underwriting practices.

"What strikes me in this report is the very detailed road map — we have the plans and we know what needs to happen to manage these risks, is what this report says," said Emilie Mazzacurati, founder and CEO of 427, a Moody's affiliate that specializes in climate risk. "Should this become a priority, there's a very clear set of actions the market should expect to see from financial regulators and supervisors."

U.S. regulators have paid more attention lately to climate change and the increasing frequency of severe weather events, but they had stopped short of embracing stress testing for climate risks. The CFTC study, called "Managing Climate Risk in the U.S. Financial System," stands out for directly addressing the financial implications of environmental threats and recommending specific actions to address them.

The Office of the Comptroller of the Currency, the Federal Reserve Board and the Federal Deposit Insurance Corp., all declined to comment on the report.

The subcommittee that wrote the report, which included several bankers and officials from the government and nonprofit sectors, outlined a possible stress-test pilot and urged regulators to study the steps already taken by central bankers in Europe and elsewhere.

The pilot should include agricultural and other community banks as well as regional banks, and it should test balance sheets against "plausible and relevant" climate scenarios, the report said. It should cover financial institutions' responses to climate-related risks and opportunities over defined time horizons.

The report called for greater research into and attention to what it calls subsystemic shocks, or climate events affecting a particular geography, sector or asset class. An example of a subsystemic shock might be the wildfires across the Western U.S., which have been exacerbated by warmer global temperatures.

"Subsystemic shocks related to climate change can undermine the financial health of community banks, agricultural banks, or local insurance markets, leaving small businesses, farmers and households without access to critical financial services," the report said.

Besides stress tests, the subcommittee recommended that regulators promote information sharing across the industry and conduct greater research into climate-related shocks. This could mean banks would need to collect more and different kinds of data on their clients, especially commercial clients, and integrate that data into their risk management processes.

Climate-risk-related capital requirements could even be part of the discussion someday, the report said. It did not explicitly recommend special capital requirements, but the report said the Dodd-Frank Act gives regulators the authority to "prescribe more stringent prudential standards based on the riskiness, complexity, size and 'any other risk-related factors the [Fed] Board of Governors deems appropriate.' " And that could include enhanced capital requirements.

The report also recommended that regulators assess the balance sheets of Fannie Mae, Freddie Mac and other government-sponsored enterprises for climate-related risks. And it recommended that the Financial Stability Oversight Council — which includes banking and other financial regulators — incorporate climate risk into its regular oversight and reporting functions, coordinate information sharing across member agencies and develop a long-term research program on the subject.

Perhaps most notably, the report suggests that no congressional action would be needed to implement its advice. Regulators already have the authority to do many of these things under existing statutes and rules, the report said.

The industry has already gotten a small preview of what this kind of scrutiny might look like, said Paul Noring, managing director and leader of Berkeley Research Group's financial institutions practice.

Regulatory attention to flood risk in general has increased over the last five to six years. In particular, regulators have begun to look more closely at flood risk in commercial portfolios, he said.

"More and more exams were focused on commercial, and banks' processes around commercial just generally are not as strong on flood compliance as they are on the residential side," Noring said. "More properties are being impacted by it. They maybe weren't in an area that was typically thought to flood, but now you're experiencing significant floods, which you hadn't before."

Mazzacurati, too, cited commercial lending as a vulnerability for the banking industry. While banks possess granular detail on the residential mortgage loans they originate, they may not necessarily know the location of every piece of property a large corporate client owns — let alone whether that property is at higher risk to damage from hurricanes, severe flooding or fires.

While acknowledging that climate change poses a real systemic threat to the industry, the Bank Policy Institute — a trade group representing 42 of the largest banks in the country — also identified a lack of data as one of the challenges to implementing stress testing.

"Stress testing for long-term climate change … is an extraordinarily complex and difficult endeavor given a lack of data, established modeling techniques and the need to forecast over longer time horizons than economic stress testing has ever contemplated," the institute's president and CEO, Greg Baer, said in a statement.

The report urged greater disclosure across the financial sector, something that experts say is long overdue.

"We don't know what we don't know," said Kristen Sullivan, a partner with Deloitte who leads the firm's sustainability practice. "Absent effective and reliable disclosure around risk, the market's not able to price risk."

"Market participants need to understand the risks that are out there and need to have a framework to be able to manage the risk," said Blaine Townsend, director of sustainable, responsible and impact investing with the investment management firm Bailard. "Regulators taking this step to identify the risks and create a road map to dealing with them is very important."

David Reiling, CEO of the $1.4 billion-asset Sunrise Banks in St. Paul, Minn., said that without carbon pricing, another one of the report's recommendations, efforts like stress testing may fall short of the broader objective. There are several ways to achieve it, but carbon pricing is a market-based strategy that essentially encourages companies to reduce their greenhouse gas emissions by making polluting more expensive. The Business Roundtable, a lobbying group made up of CEOs from some of the largest U.S. corporations, recently announced its support for carbon pricing, though it did not endorse a particular method.

"One underlying question I would have is if there's a will to do it, politically, financially, socially in the U.S., specifically," Reiling said. "I would even say that moving a regulator into this space, there really aren't a lot of regulations to fall back on, other than general risk categories to the business model. There's no climate or carbon metrics to be held accountable to."

Mazzacurati says that in the long term, some of the stress testing and scenario analysis results may mean banks need to make some tough choices about underwriting certain loans. If borrowers in certain regions cannot obtain fire insurance, for example, that may lead some banks to decide it simply isn't worth the risk of lending in those places. Reviewing the aggregate risk across their own portfolios could also eventually lead banks to price certain loans higher to reflect climate-related risks, she said.

The report's authors emphasized that its recommendations are merely a starting point for understanding and preparing for the potential risks of more severe weather events.

In introducing the report, subcommittee chairman Bob Litterman, risk committee chairman and a founding partner at the registered investment adviser Kepos Capital, drew a direct comparison to the pandemic in warning about the consequences of inaction on climate change.

"A recent study suggests that, in the case of the virus, delaying social distancing by one week in the United States doubled the number of deaths," he wrote in the foreword. "Similarly, every year of delay in the policy response to climate change will lead to a higher mean global temperature increase and to greater probability of irreversible and catastrophic damages."

COMMUNITY BANKS

Did Seacoast wait too long to strike a deal?

By Paul Davis
September 18, 2020

Seacoast Commerce Banc Holdings in San Diego spent two years looking for a buyer before it agreed this summer to be sold to Enterprise Financial Services in St. Louis — at a big discount to what it could have received just last year.

Seacoast's story illustrates just how much the pandemic is changing the math behind merger negotiations, as well as the pressure on potential sellers to lower their pricing expectations or try to hang on until M&A activity picks back up.

The $1.3 billion-asset Seacoast first discussed selling in August 2018, according to a recent regulatory filing.

Deteriorating market conditions, largely because of the coronavirus pandemic, took a bite out of Seacoast's valuation and significantly reduced the price of the deal. The final $156 million price announced on Aug. 20 of this year was 13% lower than Enterprise's initial offer in early 2019 — one that the Seacoast board rejected.

Seacoast's board, based on concerns about growth challenges for banks of similar size, hired Keefe, Bruyette & Woods as its investment bank on Sept. 19, 2018. Though "extreme market volatility" led the board to table the issue in October, it instructed KBW a month later to reach out to "a few selected banks" to arrange introductory meetings with Richard Sanborn, Seacoast's president and CEO.

Executives at the $8.4 billion-asset Enterprise had their first call with Sanborn in December 2018. An in-person meeting followed a month later.

An unnamed party sent Seacoast a cash-and-stock offer on Jan. 28, 2019, with a value of $25 a share, or roughly $234 million, contingent on the buyer raising capital to help fund the deal. But Seacoast's board was concerned that volatile market conditions could threaten the proposed capital raise, the filing said.

KBW contacted 30 potential buyers in February 2019. Seven, including Enterprise, signed nondisclosure agreements and were allowed to conduct due diligence, but only three presented offers.

Enterprise proposed paying $18.83 to $19.32 a share, or $176 million to $181 million, with stock making up 80% of the consideration.

Another party offered $21.29 a share, or $199 million, while the company that had offered $25 a share stayed the course.

Seacoast's board, after reviewing the offers on March 5, determined that each "was not acceptable" and "decided to end the sales process and remain independent," the filing said. Enterprise and one of the other bidders told KBW they were not interested in increasing their offers.

While Seacoast continued to discuss a deal with the first bidder, the board decided in May 2019 that there were too many risks and uncertainties, including a post-closing plan that called for expanding into "new and enhanced lines of businesses and markets," the filing said. The other company was also struggling to get investor interest in the deal.

Still, Seacoast remained committed to a sale entering 2020, and KBW reengaged with "a limited number of banks" in February. The board briefly considered an initial public offering, along with other "avenues of liquidity" if a sale didn't happen, the filing said.

Enterprise reemerged on March 6, when its management team joined a call with Seacoast executives to discuss budget and financial forecasts and modelling assumptions in areas such as cost savings, merger-related expenses and share counts.

That led Enterprise on March 11 to propose an all-stock deal valued at $13.46 a share, or roughly $129 million, based on closing prices the day before. It was 27% lower than the offer Enterprise made a year earlier.

But the filing contends that the new offer had an implied value of $18.11, based on Enterprise's average stock price over the prior 30 days. And the exchange ratio was 5.6% higher than that of the 2019 bid.

At a March 12 meeting, KBW told Seacoast's board that there were few banks in a position to pay a premium that directors would consider acceptable. The investment bank also notified the board that market conditions were "deteriorating at an accelerated pace."

The COVID-19 outbreak was declared a global pandemic on March 11. A national emergency was declared in the United States two days later.

Seacoast's stock fell by nearly 20% between March 9 and March 12. Enterprise's shares decreased by 12% over the same period.

While it wanted a higher exchange ratio as a condition of exclusive negotiations, Seacoast's board decided to keep talking to Enterprise.

Jim Lally, Enterprise's president and CEO, and Keene Turner, the company's chief financial officer, joined a videoconference with Seacoast's board on March 13 to build a rapport and to answer questions from directors.

The deal took a backseat in mid-April, when Seacoast suspended talks to focus on its participation in the Paycheck Protection Program.

Seacoast, a prolific Small Business Administration lender, realized it "would be unable to focus on serving clients while simultaneously trying to provide all the information that Enterprise needed" to take their discussions to the next level, the filing said. Seacoast would eventually originate $92.5 million in PPP loans.

By May 5, Seacoast had rejoined the talks, though it asked KBW to contact other banks in case Enterprise was unwilling to offer an acceptable price.

Another party emerged in late May, offering $13 a share, or $124 million. Enterprise followed on June 1 with an offer of $14.68 a share, or $140 million.

Seacoast's board decided on June 4 to give each one more chance to increase their offers.

Enterprise's final offer was $17.50 a share, or $167.4 million at the time, while the other party proposed $15.46, or $147.9 million.

"The Seacoast board … concluded that Enterprise's historic financial performance was stronger than [that of the other company] and that Enterprise had more potential upside over a multiyear period," the filing said. And Enterprise "had conducted much more due diligence over a longer period of time."

Enterprise conducted due diligence over the summer, operating under an exclusivity agreement. It sent an initial draft of the merger proposal to Seacoast on July 13.

Seacoast's board approved the final version of the merger agreement on Aug. 19; it was announced the next day. The final deal value in part reflects a 14% decrease in Enterprise's stock between June 4 and the announcement.

The deal, which values Seacoast at 151.2% of its tangible book, is expected to close later this year or in early 2021.

Enterprise expects the acquisition to be 4% accretive to its 2021 earnings per share, excluding merger-related expenses, and 11% accretive the next year. It should take less than three years for Enterprise to earn back the expected 2% dilution to its tangible book value.

The plan is to cut a quarter of Seacoast's annual noninterest expenses. Enterprise plans to incur $17.9 million in one-time expenses.

"We are excited to announce this transaction and believe the combination … is an excellent fit for our business model," Lally said in a press release announcing the deal. Seacoast has "built an extraordinarily successful SBA platform that will complement our commercial and specialty lending verticals."

COMMUNITY BANKING

Byline in Chicago joins list of community banks closing branches

By Paul Davis
September 18, 2020

Byline Bancorp in Chicago is planning to close a fifth of its branches.

The $6.4 billion-asset company said in a press release Friday that it will shutter 11 of its 57 locations. The closings will begin on Dec. 31.

Byline said the closures will target overlapping branches, with most within two miles of another office.

Byline said it will record a $5.9 million charge in the fourth quarter tied to the move.

The closings should save Byline $4.3 million annually starting in 2021. Some of the savings will be reinvested to improve the company's digital banking platform, including investment in electronic document signing, online account openings and digital small-business lending. Some funds will be used to renovate other branches.

"The changes we are making to our retail branch network reflect the accelerating adoption of digital banking channels by our customers that has occurred during the COVID-19 pandemic," Alberto Paracchini, Byline's president and CEO, said in the release.

"We believe the continued streamlining of our branch network and the increasing leverage we expect from our digital platform will result in improved efficiencies that will positively impact our level of productivity while continuing to provide our customers with the service they deserve," Paracchini added.

Several banks have announced branch shutdowns recently, including First Commonwealth Financial in Indiana, Pa.; WesBanco in Wheeling, W.Va.; Mercantile Bank in Grand Rapids, Mich.; and Nicolet Bankshares in Green Bay, Wis.

MAIN STREET LENDING PROGRAM

Fed, Treasury clarify underwriting rules for Main Street loans

By Hannah Lang
September 18, 2020

WASHINGTON — The Federal Reserve and the Treasury Department clarified underwriting expectations for lenders participating in the Main Street Lending Program in a set of frequently asked questions Friday in an attempt to assuage bank concerns of taking on added risk.

The $600 billion Main Street Lending Program was established using money from the Coronavirus Aid, Relief and Economic Security Act to help businesses with up to 15,000 employees or $5 billion in annual revenue that were in sound financial shape before the pandemic, and offers loans of $250,000 to $300 million.

Only a fraction of the funds allocated for the program have been put to use since the Fed started purchasing loans in July. Fed Chair Jerome Powell said Wednesday that about $2 billion in Main Street loans has been issued so far, and acknowledged that lenders were concerned about keeping 5% of those loans on their books. The Fed is purchasing the other 95% through a special-purpose vehicle.

But some banks have been nervous about having skin in the game on Main Street loans, and recent reports allege that Treasury has instructed banks to not let borrowers default, potentially scaring banks from taking on the risk.

"Banks like to make good loans — that's what they do," Powell said during a press conference. "They're trained to make good loans, so you should expect that they, and we expect, that they will do some underwriting. We also want them to take some risk, obviously, because that was the point of it, and the question is, how do you dial that in? It's not an easy thing to do."

The Fed and Treasury looked to soothe some of those fears on Friday, emphasizing in the new FAQs that lenders should not make Main Street loans based on a borrower's current financial state, which may have been damaged by the coronavirus, and should instead evaluate potential Main Street borrowers' pre-pandemic financial condition and post-pandemic prospects. Lenders should also factor in the payment deferral features available to Main Street loans, the Fed said.

The FAQs were also developed in consultation with the Federal Deposit Insurance Corp. and the Office of the Comptroller of the Currency, the two other banking regulators, and offered more information on how bank examiners will treat Main Street loans.

Supervisors will not rebuke banks for Main Street loans that were made in compliance with the program's requirements, the Fed said, including loans that could be considered "non-pass" at the time of the origination, as long as the weaknesses in those loans derive from the COVID-19 pandemic.

HIRING

Citi to hire 6,000 young people in Asia as joblessness soars

By Bloomberg News
September 18, 2020

Citigroup is embarking on hiring 6,000 young people in Asia over the next three years in an effort to help cushion the region from a blowout in youth unemployment.

It's also offering 60,000 job training opportunities for youth below the age of 24 over the next three years across its retail and institutional businesses in the region, the New York-based bank said on Friday. Citi and the Citi Foundation pledged to invest $35 million in philanthropic contributions and grants to improve the employability of youth from low-income and underserved communities in Asia by 2023.

Asia Pacific is home to more than half of the world's youth population, estimated at 700 million people. They now account for almost half of the region's unemployed, even though they make up just 20% of the working-age population, according to the International Labor Organization.

Projections through the end of 2020 in 13 countries show sizable jumps, with youth unemployment rates doubling from 2019 in some cases, the bank said.

"Communities in Asia Pacific are facing a youth unemployment crisis, especially among low-income and underserved groups, due to the impact of COVID-19," said Peter Babej, Citi's Asia Pacific chief executive.

Asia Pacific is Citi's largest region by revenues outside North America, contributing around 25% of global revenues based on 2020 earnings reports year to date.

The jobs will be offered across different businesses in the region including banking, capital markets and advisory, markets and securities services and consumer banking, a Hong Kong-based spokesman said.

The program will cover a mixture of new positions and annual hiring needs, the spokesman said. Hiring will be done across Asia Pacific, but many of the jobs are expected to come in Southeast Asia, he said.

AML

Money-laundering report alleges banks profited by aiding criminals

By Bloomberg News
September 20, 2020

A new investigation by the International Consortium of Investigative Journalists says JPMorgan Chase & Co., Deutsche Bank AG and several global banks "kept profiting from powerful and dangerous players" in the past two decades even after the U.S. imposed penalties on these financial institutions.

The report, based on leaked documents obtained by BuzzFeed News and shared with the consortium, said that in some cases the banks kept moving illicit funds after receiving warnings from U.S. officials.

The documents identified more than $2 trillion in transactions between 1999 and 2017 that were flagged by financial institutions' internal compliance officers as possible money laundering or other criminal activity, the report said. The top two banks are Deutsche Bank, which disclosed $1.3 trillion of suspicious money in the files, and JPMorgan, which disclosed $514 billion, the analysis found.

The investigation was based on more than 2,100 "suspicious activity reports" filed by banks with the U.S. Department of Treasury's Financial Crimes Enforcement Network. The report, dubbed the FinCEN Files, was the result of an investigation by more than 100 news organizations in 88 countries, Buzzfeed said.

Bloomberg News wasn't included in the consortium and hasn't seen the leaked documents.

One example highlighted in the report: JPMorgan moved more than $1 billion for the fugitive financier behind Malaysia's 1MDB scandal, based on records. The bank also processed payments for Paul Manafort, the former campaign manager for President Donald Trump, after he resigned from the campaign amid money laundering and corruption allegations from his work with a pro-Russian political party in Ukraine, according to the investigation.

JPMorgan told ICIJ that it was legally prohibited from discussing clients or transactions. It said it has taken a "leadership role" in pursuing "proactive intelligence-led investigations."

"We report suspicious activity to the government so that law enforcement can combat financial crime," the bank said in a statement to Bloomberg News. "We have played a leadership role in anti-money laundering reform that will modernize how the government and law enforcement combat money laundering, terrorism financing and other financial crimes."

Compliance staff in big banks, often overworked and lacking in resources, relied on basic Google searches to find out the identity of the people behind money transfers, the ICIJ said. Banks often filed suspicious activity reports only after a transaction or customer became the subject of a negative news report or a government probe, when the funds are long gone, ICIJ says, citing the documents.

The Bank Policy Institute, an industry group, said banks can't tell their side of the story for legal reasons. Based on past instances, the cases are likely connected to requests by law enforcement to keep a so-called suspicious account opened so authorities are able to track where the money is going before mounting an arrest or conviction, it said.

Deutsche Bank responded in a statement that "ICIJ has reported on a number of historic issues" and those related to the bank are "well known" to regulators.

"The issues have already been investigated and led to regulatory resolutions in which the bank's cooperation and remediation was publicly recognized," it said.

DIGITAL PAYMENTS

Fintech startup Klarna is valued at $10.65 billion in new funding

By Bloomberg News
September 15, 2020

Klarna AB, a Swedish payment provider for online shoppers, is still setting its sights on an initial public offering even after its latest funding round left it roughly twice as valuable as it was a year ago.

"Over time, with the amount of shareholders we have, it's probably going to be the natural evolution," Chief Executive Sebastian Siemiatkowski said in an interview Tuesday.

He spoke after Klarna brought in $650 million in equity funding from a group of investors led by Silver Lake. Singapore's sovereign wealth fund GIC, BlackRock Inc. and HMI Capital also participated, as did Merian Chrysalis, TCV, Northzone and Bonnier. The funding round gives Klarna a valuation of $10.65 billion, it said.

The company has achieved enormous popularity, especially in the U.S., thanks to its buy-now-pay-later service. Klarna has hinted at its intention to do an IPO in the past, suggesting in December that a timeline of one to two years seemed reasonable.

Siemiatkowski said Klarna tries to be "less dependent" on the macroeconomic environment, "and more [on] when we think it makes sense for the company and the right timing for us."

He described the latest funding round as "a great opportunity to continue building a great offering for our consumers." Klarna now wants to expand in Europe, with France identified as an important market, he said.

Klarna's other backers include Permira Holdings, Sequoia Capital and the rapper Snoop Dogg, who stars in the company's commercials encouraging users to "get smoooth."

Klarna's success in the online payments market has turned it into a key challenger to firms like PayPal Holdings Inc. and Square Inc. The Swedish firm's customers can delay payments or make interest-free installments when they shop from brands like H&M or Adidas. Retailers pay Klarna a cut of purchases. Klarna's shopping app also alerts shoppers to deals or price-drops.

But the Swedish firm has faced regulatory pressure, amid concern its marketing tactic of buy-now-pay-later encourages reckless spending, especially among young people. Earlier in September, the U.K.'s Advertising Standards Authority launched a probe into Klarna's marketing practices.

Klarna says demand for its services from both retailers and consumers has soared during the pandemic. The company says it added around 200 new retailers per day in the first half of the year, but has still set aside a reserve of cash to act as a buffer given the economic climate.

A Klarna listing would take place in the U.S., where its business is growing fast, according to the CEO. Almost 9 million consumers there have used the company's services.

OPINION

Banks retreat again from residential servicing

By Christopher Whalen
September 16, 2020

At the start of 2020, the commercial banks were expanding into both lending and mortgage servicing, but that trend has since been reversed. Commercial banks have shut down correspondent channels and have pulled back somewhat in institutional warehouse lending and gestation, as industry volumes head for decade peaks. Income from bank servicing has been negative for two quarters.

The decline in the bank share of mortgage servicing comes as nonbank lenders are taking the lion's share of the expansion of volumes. Large nonbank lenders such as Rocket Mortgage, PennyMac, Freedom Financial and Mr. Cooper are taking the biggest share of refinance volumes across retail, direct and correspondent channels as the commercial banks withdraw.

Michael Fratantoni, chief economist of the Mortgage Bankers Association, recently wrote about the retreat of banks from residential lending and servicing:

"It is important to note that a growing share of mortgage originations can lead to an increase in the servicing share, as originators often have the option to retain or sell the servicing on a loan," he wrote in a column for International Banker. "Many nonbank originators (independent mortgage bankers, or IMBs) tend to be opportunistic, for example, retaining mortgage servicing assets when market values are low, selling when they are high."

All areas of loan sales by banks are shrinking as depositories withdraw from third-party acquisition of assets. Bank sales of auto loans and C&I credits have essentially gone to zero in 2020 while sales of one-to-four family mortgages have likewise fallen — this even as mortgage industry production volumes have generally risen by 30-40% for the industry in 2020.

Of note, the brief increase in bank one-to-four-family assets serviced for others above $6 trillion at the end of 2019 has been reversed in the past two quarters. Meanwhile, nonbank servicing will exceed $4 trillion by the end of this year as the industry heads for $12 trillion in total loans.

At the end of the second quarter of 2020, assets serviced for others by all U.S. banks fell to $5.7 trillion, compared with $6 trillion at the end of 2019. More important and to Fratantoni's point above, bank sales of one-to-fours have fallen precipitously since 2016, from $680 billion sold in 2Q 2016 to just $448 billion in 2Q 2020. And as the servicing balances and loan purchases by banks have fallen, so too has the value of bank-owned mortgage servicing rights, as shown in the table below.

Of course, a big part of the decline in bank MSR valuations is a result of falling interest rates and related assumptions for elevated prepayments. When a consumer exercises their right to prepay a mortgage, the owner of the MSR sees their asset evaporate — unless the servicer is able to recapture the asset via a refinance transaction. That ability to identify and close a refinance opportunity is the key skill set for mortgage lenders today.

For the top lenders noted above, the percentage of recapture rates on government loans are well into the 70s and 80s. But for smaller issuers and end-investors such as REITs and funds, prepayments are a serious threat to their continued existence.

The Federal Open Market Committee can accelerate lending with low rates, but it cannot ameliorate either the negative impact on credit years from now or the torrent of loan prepayments today. Many REITs and funds are currently attempting to raise cash by levering-up MSRs that likely won't exist a year from now. This is one reason that the book-value multiples for publicly traded hybrid REITs have collapsed.

Owners of legacy mortgage servicing also face the prospect of reduced or even negative returns due to the cost of remediating defaults and forbearance loans due to COVID. And by no coincidence, valuation multiples for MSRs have fallen by two-thirds since 2018. Meanwhile, residential mortgage lending markets face an extended boom and the public equity market valuations for nonbank lenders are soaring.

In this Fed-driven market, if you are not among the handful of hyperefficient lenders able to actually grow your servicing book net of loan prepayments, then you're probably a victim. Without a strong partner in terms of both servicing and recapture, one operator tells NMN, most end investors in MSRs such as hybrid REITs could be well advised to consider selling their remaining assets while the opportunity remains.

Since Federal Reserve Board Chairman Jerome Powell has made clear that short-term rates in the U.S. are unlikely to move higher in our lifetime, the only rational strategy for holding MSRs is to be very aggressive on protecting the servicing assets via loan recapture. This is one of the chief reasons that banks have been willing to give up share in lending and servicing of one-to-fours as they collapse back to retail-only lending strategies.

Simply stated, banks and REITs buy loans, IMBs make loans. Holding MSRs when you cannot defend the asset by recapturing the refinance event is a losing trade. This is why, for example, that early buyouts of government loans is such a popular strategy with large banks. Buy the delinquent asset, modify or refinance the loan, and sell it into a new MBS pool or just hold the loan in portfolio.

Until such time as the FOMC decides to allow short-term interest rates to rise, the nonbank share of mortgage servicing assets is likely to grow, but the composition of that nonbank constituency is going to change. Look for fewer, bigger nonbank issuers that are creating and retaining newly minted MSRs in portfolio at rock bottom valuations. And look for many fewer REITs and funds in the residential sector because of the huge premium today on the ability to efficiently create new loan assets.

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