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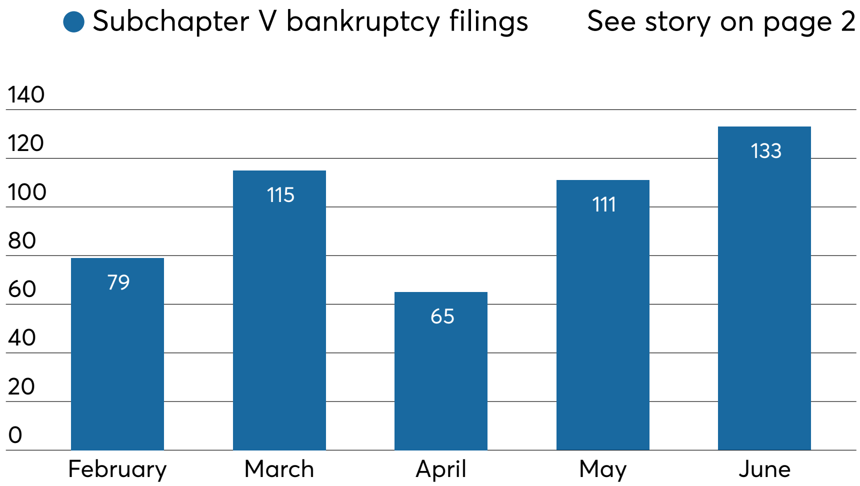
Make way for more loan mods?

More than 500 small companies have filed for bankruptcy protection under new rules that allow them to restructure home equity loans used to fund business operations. The numbers are expected to increase as the pandemic persists.



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dailybriefing

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Mortgages taken out to fund business operations can now be modified in bankruptcy. That's a relief to borrowers — particularly with business failures expected to increase as the pandemic drags on — but a possible headache for banks and investors that hold the loans. (See chart above.) **Page 2**

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LOAN MODIFICATIONS

Small-business bankruptcy program adds new risk to home equity loans

By Jon Prior
July 20, 2020

To their list of worries about how the coronavirus pandemic is affecting customers and their own bottom lines, bankers can now add this: a potential spike in home mortgage modifications tied to small-businesses bankruptcies.

Many entrepreneurs opening a business for the first time will often use the equity in their homes as collateral on loans needed to buy equipment or hire workers.

Last year, Congress made changes to the bankruptcy code that allowed borrowers to modify these second mortgages in the event their businesses fail, perhaps saving them from having to sell their homes to settle their debts. Protections were further expanded when the coronavirus relief package was passed in March.

But while these changes provide a measure of relief to borrowers — particularly with bankruptcies expected to increase as the pandemic drags on — they can cause problems for banks and investors that hold the loans.

That's because interest rates are often lowered in the modification process, reducing a loan's value. In one case involving a mortgage on a bed and breakfast in California, the owner proposed a plan in the new bankruptcy program that would have reduced the secured portion of the mortgage to the value of the property and would be paid down over a new 30-year term at 4.25% interest. The servicing company handling the loan had proposed selling the property to satisfy the owner's debts, though the case has yet to be resolved.

"It could be a headache in that a mortgage that a lender thought was not modifiable is now suddenly modifiable," said Bonnie Pollack, a partner at Cullen and Dykman who represents lenders in these new bankruptcy cases.

The new subchapter V of the Chapter 11 bankruptcy process was signed into law last year and became available in February. It provides small-business owners and individuals with business debt of up to a little more than $2.7 million with a streamlined path to restructuring. One of the advantages to subchapter V allows a residential property owner to have their mortgage modified to lower their monthly payments and ease some terms as long as the home loan was taken out to fund their business — often in the form of a cash-out home equity refinance, or collateral mortgage for business debt.

The coronavirus relief package expands, until March 2021, the debt limit for subchapter V to $7.5 million, increasing the number of potential mortgages with terms once thought set in stone at risk of being eased.

Banks have been combing through their portfolios searching for which mortgages might suddenly be modified in the new bankruptcy program. An exact number across the industry is hard to pin down, but a 2018 survey by the Federal Deposit Insurance Corp. shed some light on how often small-business owners use the equity in their homes to secure a loan.

Roughly $18.3 billion in C&I loans were secured by one-to-four unit residential properties at the time of the survey, according to the FDIC report.

A Wells Fargo spokesman, after consulting with mortgage and bankruptcy experts within the San Fransisco bank, indicated the scope of the issue has yet to come into focus but that lenders were wary of the potential impact.

"We're aware of the changes to the bankruptcy code that were enacted as part of the CARES Act and will monitor any potential impacts to our portfolio," the spokesman said, referring to the Coronavirus Aid, Relief, and Economic Security Act. "However, it's too early to speculate about what those might be."

Pollack said that loans backed by the U.S. Small Business Administration can shed some light on the size of the universe of mortgages affected by the change. The agency, Pollack said, often requires some kind of collateral for financing, which could take the form of equity tapped from a second mortgage on the borrower's home.

So far, relatively few businesses have tested the new bankruptcy program. But John McMickle, co-founder of North South Government Strategies, a regulatory affairs consultancy, said that is expected to change. Many forbearance plans banks granted to businesses at the start of the crisis are scheduled to expire in the months ahead, and it's unclear how many will be able to make their payments again. The SBA's Paycheck Protection Program stopped taking new applications on June 30. And Congress has been slow to pass any further stimulus, though negotiations are underway.

Meanwhile, there have been more than

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500 bankruptcy filings in the new subchapter V program since it launched in February, according to legal data company Epiq AACER, and the pace is picking up. Of those, 133 were filed in June alone.

"Everybody anticipates that at some point there will be an increase in these," McMickle said. "Will it work? No one really knows, especially if a lot of cases come in."

Already small business owners are testing the revised bankruptcy laws and seeking to modify mortgages secured by their residences.

James Bailey, a bankruptcy attorney and partner at the law firm Bradley, said that some small-business owners have had their modification under subchapter V challenged by the lender, notably in the case of the bed and breakfast.

The company handling that mortgage objected to the modification of the loan against a mansion that was both operated as a business and served as the owner's principal residence. The court held that it would need to consider a number of factors to determine whether the mortgage was not used primarily to acquire the property and whether the loan proceeds were used primarily in connection with the small business. Bailey said lenders should continue to monitor the development of the law in this area.

"Lenders need to be aware that this is out there," Bailey said.

SMALL BUSINESS LENDING

Watchdog urges Fed to extend more virus aid to states, small firms

By Bloomberg News
July 20, 2020

The Federal Reserve isn't moving quickly enough to get loans to cash-strapped small businesses and local governments struggling to cope with the coronavirus crisis, according to a panel created to monitor billions of dollars in aid approved in response to the pandemic.

U.S. central bank programs have purchased only two loans — one to the state of Illinois through its municipal lending facility and a $12 million package through its Main Street lending program, which only became operational on July 6, the Congressional Oversight Commission said in a report released Monday.

"Our initial reaction is that a purchase of one $12 million loan over a week and one half seems like a small amount, given the economic challenges facing some small and medium sized businesses," the panel said in its third monthly report.

In previous reports, the panel has said that Fed and Treasury Department relief efforts might be falling short in helping small business and state and local governments and found that only a small fraction of the money allocated for loans has been spent. In the new report, it said the Fed has lent only $13.6 billion of the $454 billion allocated for its programs, raising questions about whether the eligibility requirements need to be loosened.

The commission was created at the insistence of congressional Democrats during negotiations that led to approval of the $2.2 trillion CARES Act stimulus package earlier this year. The new report comes as Congress begins negotiations over another round of stimulus, which Democrats say must include more money for states and local governments. President Trump met with top Republican lawmakers on Monday to iron out differences over a GOP-only proposal.

Members have said the lack of a chairman has hampered the panel's ability to establish a strategy for policing the $500 billion in bailout money. Joseph Dunford, a former chairman of the Joint Chiefs of Staff, withdrew from consideration for the post earlier this month.

The oversight panel has four members: Democratic Rep. Donna Shalala of Florida; GOP Sen. Pat Toomey of Pennsylvania; Bharat Ramamurti, a former aide to Sen. Elizabeth Warren of Massachusetts; and GOP Rep. French Hill of Arkansas.

TRUMP ADMINISTRATION

Big banks urge HUD to shelve redlining plan. Small banks say not so fast.

By Joe Adler
July 20, 2020

WASHINGTON — In what is a sea change from their prior stance in "disparate impact," big banks are urging the Trump administration to reconsider plans to weaken fair-lending rules. But the banking industry is far from united in that view, and so far the agency responsible for enforcing fair-lending laws, the Department of Housing and Urban Development, has shown no willingness to abandon the proposal.

Large lenders including Bank of America, Citigroup, JPMorgan Chase and Wells Fargo all urged HUD to withdraw a plan that would put more of an the onus on borrowers to prove discrimination when bringing redlining claims against lenders. They argue that the proposal, first introduced a year ago, would weaken efforts to curb discrimination at a time of intense national focus on racial equity.

But small banks continue to support the proposal, saying it would reduce frivolous claims and help focus fair-lending enforcement on catching the truly bad actors.

"We do not want to see the proposal retracted," said Lilly Thomas, executive vice president and senior regulatory counsel at the Independent Community Bankers of America.

A 2015 Supreme Court decision affirmed disparate impact, which enables plaintiffs to allege discrimination even if a lender did not show discriminatory intent. But the ruling also suggested that HUD should restrict how the legal doctrine is applied.

The HUD proposal would establish a five-step procedure for a consumer to demonstrate discrimination. Consumer advocates have argued that the plan would effectively make the burden of proof too high.

The industry initially supported the plan widely.

In an October 2019 comment letter, the Mortgage Bankers Association, whose membership includes the nation's largest banks, said it "supports HUD's decision to amend its disparate impact standard to" be consistent with the Supreme Court ruling."

But following nationwide protests over systemic racism in the aftermath of the killing of George Floyd, large lenders and their trade groups have changed course.

"At a time when we as a nation are having important and too-long-ignored conversations about racial inequality, we believe it is appropriate to withhold publication of the final disparate impact rule," Robert Broeksmit, the MBA's president and chief executive, wrote in a July 16 letter. "Instead, we call on HUD to bring the housing, lending, and civil rights communities together for renewed discussions about how to address the stubbornly wide housing and wealth gaps faced by communities of color that still exist — and by some measures have grown worse — more than 50 years after the passage of the Fair Housing Act."

BofA, Citi, JPMorgan, Quicken Loans and Wells Fargo expressed similar sentiments in letters of their own. They cited recent events — including the heavy impact of the coronavirus pandemic on low- and moderate-income communities — and the nationwide conversation about systemic racism as justifying a pause in the rulemaking effort.

"Now is the time for all of us to rededicate ourselves to the principle that everyone should be afforded the full protection of equal and fair justice under the law," wrote Mark O'Donovan, CEO of JPMorgan's home lending division. "We look forward to continuing to work with HUD on a disparate impact rule that preserves the ability to effectively address unintentional discrimination. This collective effort is critical to ensuring economic fairness and equal access to housing."

Housing advocacy groups have hailed the big banks' sudden change of heart.

"It's really an inflection point in the industry. This is the first time this has ever happened," said Lisa Rice, president and CEO of the National Fair Housing Alliance. "Heretofore we have never been able to successfully get the industry to rethink its position on disparate impact."

Rice said the HUD proposal had previously already made some within the industry uncomfortable since it was seen as raising a barrier to disparate impact claims. The protests following George Floyd's killing were "the straw that broke the camel's back," she said.

"The rule is so bad that it even shocked some people in the industry," Rice said. "There was a lot of infighting over this Trump [rule]. There were a lot of people in lending institutions who were saying, 'We can't go this far, guys.' "

It is unclear whether HUD is considering any change in plans, but the initial response from the department's leadership appeared to maintain support for the plan's rationale.

After The Wall Street Journal reported on the letters from Quicken and BofA, HUD Secretary Ben Carson indicated there were continuing concerns that the current disparate impact framework — developed in the Obama administration — is too broad.

"What people need to understand is that it is so wide and so broad, the way it is written all it provides is permanent employment for lawyers," he said in an appearance on Yahoo Finance.

In a July 14 letter to Bank of America, Deputy HUD Secretary Brian Montgomery wrote that "the leadership and professional staff at HUD is working on a daily basis to live up to the spirit of the Fair Housing Act."

"Although the Supreme Court decision did not address HUD's rules directly, the Court went out of its way to urge caution in applying disparate impact theory in a manner that might undermine the very mission of both fair housing and helping to develop communities that suffer from lack of investment," Montgomery said, adding later that the department will review all comment letters "it received before issuing a final rule later this year."

Some observers suggested the big banks' recent stance won't affect the administration's plans.

"If I had to guess ... it's just conjecture, but I imagine they'll go forward with it," said Stephen Ornstein, a partner with Alston & Bird.

The ICBA's Thomas acknowledged that the industry is split between big banks and small banks on the issue.

"Supporting a proposal that comports with the United States Supreme Court decision in no way whatsoever implies or intends to suggest that we support illegal discrimination at all, or any community banks do," she said. "Those are very separate issues."

She said the current disparate impact regime uses "a huge net to capture a minnow."

"Certainly, we want to identify and hold bad actors accountable for illegal discrimination," Thomas said. "What we don't want to see is a lot of frivolous and false positives going through the system, tying up the system, costing a lot of money. Those costs would inevitably flow down to consumers. What we want to see is targeted and quality repercussions for bad actors."

Ornstein said the large banks calling for the plan to be tabled may be calculating that whatever rule the Trump administration writes could be quickly overturned if the presumptive Democratic nominee, Joe Biden, wins in November.

"In a Biden administration, if the rule were to be implemented, at the end of the Trump administration, it would probably be withdrawn. It may not have a full shelf life as it is," Ornstein said. "I think you'll see a sea change in how these laws are enforced in a different administration."

FDIC

FDIC floats certification program for fintechs working with banks

By Miriam Cross

July 20, 2020

The Federal Deposit Insurance Corp. is seeking comment about a potential set of standards and a certification program intended to make it easier and less costly for financial institutions to partner with technology firms, the agency said Monday.

The request for information will address several matters. For instance, it seeks comment on the idea of the FDIC partnering with a standards-setting organization that would develop best practices for technology firms that want to work with banks. The standards-setter would focus on areas such as credit underwriting models.

The FDIC is also exploring the possibility of a voluntary certification program that would assess a technology company's compliance with the standards.

"Fostering innovation in the financial sector is a top priority for the FDIC," Chairman Jelena McWilliams said in a press release. "We have to remove unnecessary regulatory impediments that banks must overcome when developing or deploying new technologies."

The agency expects the program will be particularly beneficial to community banks that may not have the budgets to invest in their own technology, or lack sufficient staffing or the technical expertise to properly assess new products.

"The cost to innovate is in many cases prohibitively high for community banks," McWilliams said in October during a speech at the Federal Reserve Bank of St. Louis. "They often lack the expertise, the information technology, and research and development budgets to independently develop and deploy their own technology. That is why partnering with a fintech that has already developed, tested, and rolled out new technology is often a critical mechanism for a community."

The FDIC's program could also benefit fintechs seeking partnerships with community banks. A tech company could potentially apply for one certification that would be accepted by many institutions rather than spending time and resources on a patchwork of different requirements.

The request for information is part of the FDiTech initiative, which aims to promote the use of new technologies across the financial services sector. The public will have 60 days to provide comments.

DIGITAL BANKING

The challenger banks reaching Gen Z

By Miriam Cross
July 16, 2020

When Andrew Vahrenkamp was looking for a prepaid debit card for his 10- and 13-year-old children to hold their allowance dollars, he couldn't find what he was looking for at traditional banks. He ended up choosing a prepaid debit card from chore app BusyKid, which he liked for its interface that allowed his kids to check off their chores, the convenient way money could get from his checking account to their cards, a low annual fee and charitable and investing components.

"The days of teens going to the mall and buying stuff with cash are gone," said Vahrenkamp, senior research analyst at Raddon, a research and analytics company. "They have ownership of this card and it helps them learn financial habits."

BusyKid, with 250,000 users, is one of a growing crop of fintechs with cards and apps specifically designed for Gen Z. Unlike with some past attempts at this same concept, these newcomers are gaining traction: One, Greenlight, has nearly 2 million customers. Another, gohenry, has 1 million.

A look at what these fintechs are offering gives a glimpse of the kinds of products younger customers are going for (Generation Z generally refers to kids born in 1996 or later). Their strategies also offer clues as to what banks are missing when they target young customers, who can age with a traditional institution in a way they may not be able to with a more niche service.

Many traditional banks offer student or teen checking accounts and kids' savings accounts.

Apps and accounts such as Greenlight, gohenry, Step and an upcoming Junior account for U.S. customers from the challenger bank Revolut offer kids, tweens and teens such features as debit cards they can personalize (and their parents can oversee), fast money transfers, goal tracking and more.

"There is a real misunderstanding about how teenagers and preteens need to shop and spend that some of these fintechs are seeing and banks aren't," said Vahrenkamp. "At the moment we see almost no Gen Z interest in calling a tech company their primary financial institution. But the risk they could is pretty high."

At a December conference, Julia Carreon, the managing director of digital and fiduciary operations at Wells Fargo Wealth Management, put it starkly. "Over the next 10 years, the largest turnover of generations in sheer numbers will occur in our lifetime," she said. "The silent generation will die. Boomers will exit the workforce. The much infantilized, forever-frozen-in-time millennials will turn 40, and we will witness the rise of Gen Z."

What Gen Z values

Vahrenkamp and Karen Kislin, strategic adviser at Raddon, list a number of things that Generation Z wants from banks, based on surveys they've done: simplified account offerings (perhaps a checking account that encourages good savings habits, such as the one offered by SoFi); low and transparent fees; a robust mobile app; and customer service that will readily solve their problems — because it's easier than ever to switch banks if one is unhappy.

The importance of strong savings tools is echoed in observations by Carreon.

"Seeing their parents lose their jobs, watching older millennial siblings move home and the rise in higher education tuition and student debt has resulted in Generation Z having a more conservative view of finances," she said in a May webcast. "They're even more conservative and worried than millennials were."

One more elusive feature is financial education through video tutorials. In an upcoming study, Raddon found that when asking whether consumers would bring more business to a financial institution that offered financial literacy, 63% of Gen Z respondents said yes, compared to 42% of the general population.

"My favorite advice to give financial institutions is to find their most Gen Z-looking employee, and they are now their financial literacy spokesperson for short video clips they will be posting on YouTube and Instagram," said Kislin.

Few, if any, institutions are taking her up on this tactic.

But Greenlight, a debit card and app, and gohenry, a similar service that originated in the United Kingdom, are making a push to foster responsible habits among young customers in other ways.

Greenlight, which raised $54 million in Series B funding from JPMorgan Chase, Wells Fargo and other investors in 2019, began in 2017 as a spending account and debit card with parental spending controls. It has evolved to let kids track their savings goals, donate money to charity through an embedded Give account, manage their chores and more. Parents can pay interest on their children's savings, and the average rate is 18%, according to the company.

In the third quarter, Greenlight plans to debut an investing component where kids can research and buy exchange-traded funds and stocks (including fractional shares) with their parents' help.

There is no minimum or maximum age to use Greenlight, but the average age of nonparent users is 12, said Tim Sheehan, the CEO and a co-founder of Greenlight.

Although customers can find many of these features elsewhere, Sheehan said that Greenlight sets itself apart by offering a holistic view of personal finances. "There are chore apps and allowance apps. You can go to a bank and get a checking account, and open an investment account for kids," he said. "Greenlight is all of those things."

Young customers have been amassing more funds during the coronavirus crisis, Sheehan said. "You can see how the pandemic would affect spending, because kids do a lot of in-person transactions, but the money has been going towards savings, not just sitting in their spending account," he said. He found that kids' average savings account balances increased by 31% during the pandemic compared to prior to the pandemic.

"Wells Fargo invested in Greenlight because we understand the significance of helping children build healthy financial habits early on that can lead to sound money management skills in the future," Tom Richardson, head of strategic investments for Wells Fargo Strategic Capital, said in an email. "The shift to digital money platforms is undeniably relevant in our current environment, and we recognize the increasing need for these solutions that enable parents to set their kids up for financial independence and success."

Like Greenlight, gohenry lets parents transfer allowance money onto its debit card and add tasks for their kids to complete. Parents will get notified about transactions and can set controls over where their children spend money and how much they spend.

The service launched in 2012 and came to the U.S. in 2018. It counts one million customers around the world, targeting families with kids between the ages of 6 and 18.

Dean Brauer, co-founder and executive vice president (U.S.) of gohenry, noted that Gen Z members interact with money differently than their parents do.

"How do you teach kids to be competent with managing a budget when cash is not tangibly passing through their hands?" Brauer said. "Gen Z might be the first cashless generation, and with COVID we're seeing an acceleration of a cashless society."

Another thing gohenry has in common with Greenlight is a heavy focus on digitizing allowance. "Customers always tell us they want to get into an allowance regime because they believe that's a big part of helping kids manage a budget, but with cash they often forget or don't have the right change," Brauer said. "When you make it automatic, it builds that consistency."

The company is also working on more features to cater to older teens for later this year, such as account and routing numbers and peer-to-peer transfers.

Both Greenlight and gohenry charge monthly subscription fees: $4.99 a month for Greenlight (with debit cards for up to five kids) and $3.99 a month per child for gohenry.

"We didn't want to be in a position where we were trying to push kids to spend for interchange revenue," Sheehan said.

Kids can also customize their debit cards with a design or photograph — a gimmick, but a gimmick that works, according to Vahrenkamp.

"You'd be amazed at what people care about when it comes to a card," said Vahrenkamp. From his own experience, he estimates that fancier or heavier cards can increase transaction volume by 10% over previous transactions with standard cards.

Features are sparser with Step, a mobile bank account that focuses on customers ages 13 to 18 and quietly launched this year. Over half a million users have downloaded the app and signed up.

The major feature that Step has rolled out so far is a peer-to-peer money transfer service.

While such services are plentiful, "none are tailored to the under-18 market," said CJ MacDonald, CEO and founder of Step. "Venmo is great, but you still need an underlying bank account."

Unlike the others, Step does not charge monthly fees. The company expects to make money from interchange fees along with other, yet-to-be-announced revenue streams.

For now, none of the apps have a firm plan (and they're not necessarily searching for one) to hold on to customers in their 20s, 30s and beyond. But when it comes to competing with banks, that may not matter.

"We're starting to see that with millennials, there is less and less of a traditional primary financial institution and they are starting to spread out across a multitude of not just traditional banks, but fintechs as well," Kislin said. "In the midterm, the real risk is seeing more disruption of Gen Z spreading out amongst competitors."

EARNINGS

Custody banks hurt by absence of commercial lending

By John Reosti
July 17, 2020

Bank of New York Mellon and State Street in Boston have been struggling with their balance sheets.

While core fee-generating businesses helped the custody banks' second-quarter profits, their traditional banking operations have been hampered by fallout from the coronavirus outbreak.

Net interest income at the $280 billion-asset State Street fell by 16% from the first quarter to $559 million. Chief Financial Officer Eric Aboaf warned on Friday that another 9% to 11% decline is likely in the third quarter.

The $442 billion-asset Bank of New York Mellon reported earlier in the week that its net interest income fell 4% in the second quarter, with an expectation of an 8% to 11% decline in the current quarter.

Low interest rates in the wake of emergency cuts by the Federal Reserve were largely to blame, executives at the companies said.

"When you look at the third quarter, it's really all about rates coming down and getting the full impact of that for the full quarter, that's really the primary driver," Michael Santomassimo, Bank of New York Mellon's CFO, said during a conference call Wednesday.

Unlike other large banks, State Street and Bank of New York Mellon did not participate in the Paycheck Protection Program. Many other banks were able to bring in millions of dollars in PPP loans, along with low-cost deposits, and they will eventually collect fees that will be included in net interest income.

At the same time, neither bank is a major player in commercial and industrial lending or commercial real estate.

Total loans at State Street fell by 17% from the first quarter to $26.9 billion, while deposits decreased by 92% to $200.5 billion. Bank of New York Mellon's loan portfolio shrank by 11% to $55.4 billion, and deposits declined by 9% to $305.5 billion.

Those declines highlight the importance of the companies' fee businesses and expense management.

Overall, State Street's earnings rose by 9.5% from a quarter earlier to $694 million. Bank of New York Mellon's profit was flat from the first quarter, at $965 million.

State Street was able to reduce expenses for the first six months of 2020 by 2% from a year earlier, CEO Ronald O'Hanley said during the company's earnings call. "We cannot control the economic environment, but we can control our expenses," he said.

Several extraordinary steps factored into each company's quarterly results.

Low rates forced Bank of New York Mellon to waive about $80 million in money market advisory fees in the second quarter. Executives said they expect the waivers to continue through the rest of 2020.

State Street reported $14 million in net charge-offs for the second quarter tied to a decision to de-risk its $4 billion leveraged loan portfolio. The company sold about $160 million of loans at a discount.

"It effectively cost us $6 million given the necessary reserve build, so a good trade," Aboaf said.

ESG

Bank of the West launches eco-friendly checking account

By Laura Alix
July 20, 2020

Bank of the West in San Francisco has launched a checking account aimed at environmentally conscious consumers.

The $101 billion-asset bank partnered with the nonprofit 1% for the Planet on the new account, which offers users a snapshot of the environmental impact of their purchases. The U.S. subsidiary of the French BNP Paribas said it will also donate 1% of the net revenues generated by this account to environmental nonprofit groups.

"When you talk about climate change people are often at a loss as to what they can do personally to effect change," Ben Stuart, the bank's chief marketing officer, said in a press release. "The 1% for the Planet Account allows consumers not only to bank with a group that is progressive on energy policy and is striving to meet the demands of the Paris [climate] accord, but also that donates 1% of the account's revenue to address climate change at no cost to the consumer."

The product launch comes at a time of heightened industry focus on environmental, social and governance issues and on climate change mitigation in particular. Those efforts frequently include commitments to using and financing renewable sources of energy. Bank of the West has pledged $1 billion to financing sustainable energy production and has vowed not to finance Arctic drilling, tar sands mining or coal-fired power plants.

The checking account is relatively novel because of the carbon-tracking tool embedded in the mobile app associated with it. That tool relies on the Åland Index, a cloud-based program developed by the Swedish fintech firm Doconomy. The index, which Bank of the West licenses from Doconomy, calculates the carbon impact of a given transaction using the merchant code and purchase amount.

In addition to the carbon-tracking tool, the checking account includes a debit card made with compostable plastic, and the bank will waive a $10 monthly service charge with one deposit per statement cycle.

Bank of the West said that the first recipient of donations generated by the new account will be Protect Our Winters, a nonprofit that helps individuals get involved in climate activism.

CLIMATE CHANGE

Morgan Stanley to show how loans contribute to climate change

By Bloomberg News
July 20, 2020

Morgan Stanley will begin reporting the carbon emissions resulting from its lending and investments, providing greater clarity than any of its major American peers on how the bank contributes to climate change.

The firm became the first major U.S. bank to join the Partnership for Carbon Accounting Financials, Morgan Stanley said in a statement Monday. The group's 66 formal members, which represent more than $5.3 trillion in assets, are working to push the finance industry toward contributing to the goals of the Paris climate accord.

New York-based Morgan Stanley also will be on the partnership's steering committee and help PCAF develop a global accounting standard that can be used by financial institutions to measure and cut their impact on the climate. Other committee members include ABN Amro Bank NV, Amalgamated Bank and ASN Bank.

"We are excited to join PCAF and to support the important work they are leading to build a methodology for global banks' efforts to track and measure climate-change risks," Audrey Choi, chief sustainability officer at Morgan Stanley, said in the statement.

U.S. banks are the biggest financiers of polluters and have been slower to reckon with their own contribution to global climate change than many of their European peers. PCAF, which was created by fourteen Dutch financial institutions in 2015, is working to quantify the impact on emissions of funding to the carbon-based fuel industry.

JPMorgan Chase provided more loans to fossil fuel companies than any other bank from 2016 to 2019, at $269 billion, followed by Wells Fargo, at $198 billion, according to environmental group Rainforest Action Network. Morgan Stanley was No. 11 for the period, at $92 billion.

The move is a "major step in the right direction for Morgan Stanley," Ben Cushing, senior campaign representative for the Sierra Club, said in a separate statement. "Wall Street is driving the climate crisis, and if banks want to be part of the solution, they have to start by being transparent about the extent to which they're currently part of the problem."

COMMUNITY BANKING

Bryn Mawr Bank shuts down investment advisory business

By Paul Davis
July 20, 2020

Bryn Mawr Bank in Bryn Mawr, Pa., has shuttered an investment advisory business.

The $5.3 billion-asset bank said in a press release Monday that it incurred $2.3 million in expenses during the second quarter tied to winding down BMT Investment Advisers.

Bryn Mawr said the expenses included $1.8 million to shut down the business and $425,000 in severance. The bank did not provide any other details in the release.

BMT Investment Advisers, formed in May 2017, has served as the investment adviser to BMT Investment Funds, a Delaware statutory trust.

The bank said its second quarter earnings fell by 5% from a year earlier to $15 million. It lost $11.2 million in the first quarter of 2020.

BANKTHINK

Trump's attempt to weaken fair housing rules is beyond tone deaf

By Gregory D. Squires
July 20, 2020

Eradicating structural racism has suddenly appeared on the agenda of virtually all private, public and nonprofit organizations, but the Trump administration remains unmoved leading up to the November elections.

Nowhere is this more evident than in housing market and housing finance policies and proposals.

Structural racism has again catapulted to the forefront of national matters, with "Black Lives Matter" and "Defund the Police" slogans painted on streets across America. So too, corporate America has joined in the fight against inequality by committing $1.6 billion to organizations fighting racism and injustice.

Yet the Trump administration seems intent on doing everything it can to perpetuate rather than ameliorate structural racism, as well as its costly repercussions.

These patterns are not just spatial curiosities. They are at the core of a host of economic and social problems. Research has demonstrated that residents of predominantly poor and non-white neighborhoods have lower incomes, fewer and less-safe housing choices, limited access to healthy food and health care services, inferior educational opportunities and more.

Beyond this, all neighborhoods are affected in the more segregated cities, which experience lower levels of economic growth, average incomes and educational attainment in addition to higher homicide rates than less segregated cities. One can make the case that not all people of color want to reside in an integrated community, but discrimination by providers of housing services remains a central cause of the nation's segregated housing patterns.

There have been some positive developments in recent years prior to when the Trump administration took several steps to eliminate or weaken some of the key tools that have accounted for that progress.

For example, the Obama administration promulgated a rule to clarify the application of disparate impact to housing, a legal standard used to identify an unlawful practice even if there was no intent to discriminate.

But now, the U.S. Department of Housing and Urban Development has proposed a revised rule that would make it virtually impossible for a plaintiff to establish disparate impact discrimination, while making it easy for respondents to avoid liability. One defense could be that the policy or practice that adversely affected a protected class was a standard industry practice. In other words, if everybody engages in a problematic practice then it's okay.

But many lenders, including Bank of America and Quicken Loans, have urged HUD to scrap its plan to rollback this critical tool for addressing structural racism.

Similarly, HUD has proposed a new rule regarding the obligation of recipients of federal community development funds to affirmatively further fair housing. The Obama administration previously issued a clarification to this obligation that included requiring fund recipients to examine the local housing market and identify discriminatory policies and practices, then take actions to eradicate those problematic actions.

In 2018, HUD suspended this rule even though it had "yielded promising results from its early rollout." The agency has now issued a proposal that would eliminate the affirmative planning, among other fair housing requirements.

Further evidence of the Trump administration's dismantling of fair housing efforts is seen in the transformation of the Consumer Financial Protection Bureau. Created in 2011, the CFPB generated $11 billion in restitution for more than 25 million consumers in its first five years.

Since then, many investigations have been halted, industry-friendly rules have been enacted and the Office of Fair Lending and Equal Opportunity was transformed from an enforcement to an advisory body.

The Community Reinvestment Act of 1977 that was enacted primarily to prevent redlining in lending has been another target. This federal law that grades banks based on their investments in low- and moderate-income neighborhoods has generated trillions of investment dollars in underserved communities.

But CRA "reforms" recently enacted by the Office of the Comptroller of the Currency will reduce incentives that encourage such investments. Interestingly, the Federal Deposit Insurance Corp. and the Federal Reserve (which also oversee the CRA) did not join the OCC. As a result, there will be differences in the law's enforcement, which may further reduce CRA's impact.

Sadly, the louder the call for addressing structural racism, the more this administration seems to double down on its opposition to that agenda.

Hopefully, other elected officials, fair housing enforcement agencies, along with fair housing advocates will successfully resist these attacks and protect those laws that have nurtured greater justice and equality in housing and other areas for all Americans.

Gregory D. Squires is a professor of sociology and public policy, and of public administration at George Washington University. He is also a member of the advisory board of the John Marshall Law School Fair Housing Legal Support Center in Chicago, the Social Science Advisory Board of the Poverty & Race Research Action Council in Washington, and the DC Advisory Committee to the U.S. Commission on Civil Rights.

OCC

OCC seeks to clarify oversight of third-party lending relationships

By Neil Haggerty
July 20, 2020

WASHINGTON — The Office of the Comptroller of the Currency has issued a proposal to further clarify how lending relationships between national banks and third parties are regulated.

The intent is to make it easier for banks to use such relationships to "facilitate affordable access to credit," according to the proposal, which the OCC released Monday.

Banks often sell loans to third parties to manage risk and fund additonal lending. But the current legal framework has created uncertainty as to which party is the "true lender," which affects how the OCC supervises the lending relationship, the proposal says.

Under the plan, a true lender is the entity named as the official lender at a loan's origination date or the entity that funds the loan on the origination date. When a national bank is the true lender, the OCC is the prudential regulator of the activities in question.

"If the bank makes the loan in the context of a relationship with a third party, the OCC ensures that the bank has instituted appropriate safeguards to manage the associated risks," the proposal says. "In contrast, if a third party makes a loan as part of a relationship with a bank, the OCC is not the prudential regulator of the lending activity, though it still assesses the bank's third-party risk management in connection with the relationship itself."

Lack of clarity on regulatory oversight "may discourage banks and third parties from entering into relationships, limit competition, and chill the innovation that results from these partnerships — all of which may restrict access to affordable credit," the proposal says.

The proposal was issued almost two months after the OCC finalized a workaround of a 2015 court decision, Madden v. Midland Funding, that limited banks' ability to sell off loans. That rule clarified that a loan's interest rate can remain legally intact even after the loan is acquired by a purchaser in a state with a lower rate cap.

The OCC said the new proposal would "operate together" with its workaround of the Madden decision.

"Once it is determined that a loan has, in fact, been made by a bank under the clear standards set out in this proposal, the applicable federal legal framework (1) determines the interest permitted on the loan … and (2) permits the loan to be subsequently sold, assigned, or otherwise transferred without affecting the interest term, pursuant to the Madden-fix rule," the proposal says.

The OCC will accept comments on the proposal on or before Sept. 3.

FINTECH

Lawmakers grill Robinhood following 20-year-old trader's suicide

By Ryan W. Neal
July 17, 2020

The brokerage app provider Robinhood should improve its consumer protections, congressional lawmakers say, following the suicide of Alex Kearns, a 20-year-old investor who had a negative balance of $730,000 on his account.

In a letter addressed to Robinhood co-founders Vladimir Tenev and Baiju Bhatt, lawmakers press the company on how it determines which users can access risky investment strategies like options trading.

"Robinhood has been very successful in marketing itself as an easy to use and low-cost brokerage service among first-time retail investors, especially in recent months," the letter states. "By seeking to cultivate a customer base of relatively inexperienced investors, you have also taken on an especially great responsibility to make sure your customers are protected and always provided with clear and accurate information."

The letter includes 10 questions on Robinhood's options trading and how the firm determines which users are eligible to participate, among other queries.

Rep. Brad Sherman, chairman of the House subcommittee on investor protection, entrepreneurship and capital markets, signed the letter with Illinois Sens. Richard Durbin and Tammy Duckworth. Rep. Lauren Underwood, Rep. Sean Casten and Rep. Bill Foster, who chairs a task force on artificial intelligence, added their names.

The lawmakers did not respond to requests for additional comment.

In a suicide note shared on Twitter by his family, Kearns asks why "a 20-year-old with no income" was able to get nearly $1 million worth of leverage.

"There was no intention to be assigned this much and take this much risk, and I only thought that I was risking the money that I actually owned," Kearns says in the post, adding he had "no clue" what he was doing.

The lawmakers call Kearns's death "heartbreaking" and "highly alarming."

Tenev and Bhatt published a blog post in June proposing changes to Robinhood's options trading, including additional criteria for customers to trade options, more educational content and improvements to the user interface, such as messages to customers and how information is displayed in the app.

"We take our responsibility to our customers seriously and will work with the representatives and senators to address their questions and concerns," a Robinhood spokesperson said in a statement emailed to Financial Planning.

Lawmakers wonder if these changes will "have any meaningful impact" on how Robinhood enables and encourages neophyte investors to participate in risky trading.

"[The] lack of safeguards appears to correspond with Robinhood users engaging in much more high-risk and frequent trading activity relative to customers of other retail brokerages," the letter notes.

In the first quarter of 2020, the number of options trades per dollar in an average Robinhood account was 10 times higher than its next closest competitor, according to The New York Times.

This is generating "outsized" revenue for Robinhood, which sells trades to third-party firms to execute, the lawmakers claim.

The Financial Industry Regulatory Authority fined Robinhood $1.25 million in December for failing to "reasonably consider" factors including price movement when evaluating broker-dealers who execute trades.

The letter also raises concern about outages of Robinhood's trading platform in recent months during periods of market volatility. FINRA is investigating the outages and at least one user has filed a lawsuit.

Despite the challenges, Robinhood raised an additional $320 million earlier this week, valuing the company at $8.6 billion. ❑