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Extra padding

The addition of buffers to help Fannie Mae and Freddie Mac withstand economic stress would boost capital requirements under the FHFA's revamped plan

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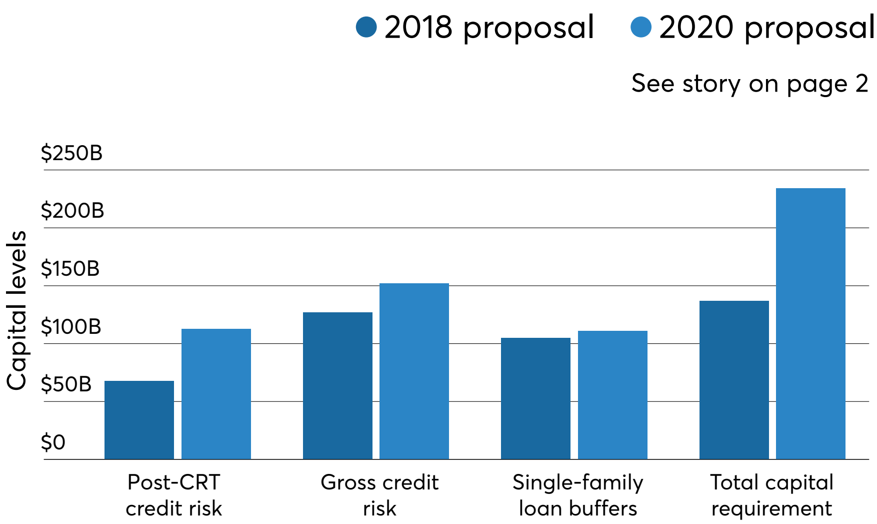

Source: FHFA

dailybriefing

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GSE REFORM

Will GSEs' record-high capital requirements scare investors away?

By Hannah Lang
May 25, 2020

WASHINGTON — As soon as the Federal Housing Finance Agency re-proposed a capital framework for Fannie Mae and Freddie Mac, some observers warned that potential investors could be scared off by the high amount of loss protection the companies would have to hold.

But others are suggesting that may be an overreaction.

The proposed target of over $230 billion in combined risk-based capital for the two government-sponsored enterprises is more than 70% higher than the amount proposed in a previous plan under former FHFA Director Mel Watt.

But the reality of the new proposal is much more nuanced. Under the new framework, Fannie and Freddie would be required to hold $135.1 billion in core regulatory capital, plus an additional $98.8 billion in three supplemental capital buffers.

Some experts theorize that the FHFA may deploy options that would allow Fannie and Freddie to technically leave conservatorship before reaching the new capital target. And while the proposal would require the GSEs to hold the additional buffers before paying dividends, the agency could show flexibility on their making capital distributions.

"Whether or not [the GSEs] have to have that capital day one of being out of conservatorship or year three is a question they ultimately need to answer and haven't yet," said Karen Petrou, a managing partner at Federal Financial Analytics.

Determining the right amount of capital for Fannie Mae and Freddie Mac has always been about striking a balance between a figure low enough to attract investors and maintain access to credit, and high enough to avoid another government bailout.

FHFA Director Mark Calabria has said previously the agency's capital rule would give investors a clear idea of what will be required once the two companies return to the private market. For a successful offering the agency needs shareholders to invest potentially record-high amounts of money.

"Nobody will invest in anything unless they understand how much capital a company is required to hold because that determines ultimately the return on equity the investor wants to price," Petrou said.

But some wondered after the FHFA debuted its new proposal on Wednesday whether the high figure would actually ward off investors. Currently, the GSEs have about $24 billion in capital, and Calabria has said it would likely take the companies more than a decade to work up to the capital level needed to exit conservatorship based on retained earnings alone.

"We have earlier argued that higher capital requirements relative to what was required under the 2018 proposed capital rule would make it more challenging for the GSEs to raise external capital," Bose George, a managing director at Keefe, Bruyette & Woods, said in a research note. The higher capital requirements would reduce an investor's return on equity to about 8%, George added.

Yet others have noted a number of methods the FHFA could deploy to bridge the gap between conservatorship and the level of capital needed for privatization, including the possibility of the FHFA using consent decrees to allow Fannie and Freddie to technically exit government control, while also implementing additional safeguards to ensure the GSEs raise the capital needed to completely operate in private hands.

And although the proposal importantly would require Fannie and Freddie to hold additional a stress capital buffer, stability buffer and countercyclical capital buffer in order to pay dividends and award bonuses, the FHFA would also have the ability to let the GSEs make capital distributions or pay bonuses upon request if it "would not be contrary … to the safety and soundness of the enterprise."

"The penalty for being below the buffer thresholds is manageable: a prohibition on capital distributions and unplanned bonuses that can be lifted at the the FHFA's discretion," said Isaac Boltansky, a policy analyst at Compass Point.

The proposal includes a chart describing the maximum payout ratio that Fannie and Freddie can make under certain circumstances, and the only scenario in which they would be completely restricted from making payouts would be if they held less than 25% of the amounts required for each of the three supplemental capital buffers.

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Still, investors could end up pricing in an additional internal buffer that Fannie and Freddie might deploy themselves to ensure that they would be able to pay dividends and bonuses, no matter what.

"If you're managing one of these enterprises and you know that if you get below the buffer, you get restrictions on ability to pay dividends and restrictions on bonuses, management is going to hold a buffer above those buffers, because they're not going to want those restrictions on their ability to pay their employees or reward their shareholders," said Mike Fratantoni, chief economist at the Mortgage Bankers Association.

Deeksha Gupta, an assistant professor of fainance at Carnegie Mellon University, agreed that a management buffer might be an important consideration for investors.

"I definitely think that investors will price in that possibility," she said. "It's either they have to have a certain capital buffer or they're going to have restrictions on dividend payments and whatnot."

However, Petrou said that for years, investors in global systemically important banks have been operating under the same knowledge that capital distributions could be suspended if a bank were to dip below required capital buffers on the Federal Reserve's annual Comprehensive Capital Analysis and Review stress tests.

"I think we need to look at the G-SIB model, and we see the same thing there where the CCAR stress testing is exactly the same thing," she said. "We've been doing this since 2009, in which once a year investors know that their dividends and capital distributions are at risk, and they price for that."

It also remains to be seen whether the Financial Stability Oversight Council might designate Fannie and Freddie as systemically important financial institutions. That label comes with additional Fed scrutiny and higher capital requirements.

Calabria, who is a voting member of the FSOC, has said that it would be appropriate for the council to discuss whether the GSEs should be designated. While the oversight council has shifted to an activities-based designation, which likely would make it more challenging to designate Fannie and Freddie as SIFIs, that approach could change should political power switch hands after the November presidential election.

"I think some of the buildup of the buffers here sure looks like that's in anticipation of whether it's a SIFI designation or just sort of universal recognition that they are SIFIs regardless of whether the designation happens or not," said Fratantoni. "And so that level of going-concern buffer and countercyclical buffer are appropriate, given their place in the markets."

Whatever the case, most experts agree that the proposed framework would to some extent cut down on regulatory arbitrage and put the GSEs on a more similar playing field in terms of capital requirements.

"Going towards higher capital requirements should help curb the kind of the riskiest lending that we saw, which many people attribute to having partially caused or worsened the 2008 housing collapse," said Gupta.

Putting Fannie and Freddie on the same capital level as banks capital-wise makes sense, said Fratantoni.

"The one goal would be, from a system perspective, that essentially the same credit risks should require the same capital, whether it's at a bank, at a GSE, elsewhere in the system, so that investors are making decisions about whether to hold that risk based upon sort of their capabilities, not on a regulatory arbitrage," he said.

M&A

Texas Capital, Independent terminate $3 billion merger

By Paul Davis
May 26, 2020

Texas Capital Bancshares in Dallas and Independent Bank Group in McKinney, Texas, have called off their planned $3.1 billion merger.

The $35.9 billion-asset Texas Capital also announced on Monday that Keith Cargill, 67, had stepped down as its president and CEO, adding that it plans to conduct a national search for his permanent successor. Cargill was set to relinquish day-to-day management of the combined company had the merger closed.

Texas Capital and the $15.6 billion-asset Independent said they were going their separate ways after the coronavirus outbreak hurt global markets and the companies' ability to meet the merger's objectives.

"Due to the unprecedented impact of the COVID-19 pandemic, both companies' boards … believe it is in the best interests of our employees, clients and all of our shareholders to focus on managing our business during this time," Larry Helm, Texas Capital's chairman, said in a press release.

No termination fees will be assessed.

The deal, in December, would have created a $50 billion regional bank in Texas. David Brooks, Independent's chairman and CEO, was set to lead the combined company, with Cargill becoming a special adviser.

Fallout from the COVID-19 crisis has created turmoil in the energy sector, which has hurt banks that focus on the sector.

Texas Capital lost $19 million in the first quarter after recording a $96 million loan-loss provision. The company set aside $55 million for two energy loans and another $30 million to address potential issues tied to the pandemic.

Texas Capital, in a separate release, disclosed Cargill's departure. The company said Helm, 72, will serve as interim CEO until a permanent leader is hired. Helm is a former regional executive for Bank One.

Cargill will serve as vice chairman until the end of this year to help with the transition.

Texas Capital said it is working with the executive search firm Egon Zehnder to identify candidates to succeed Cargill.

"As part of our focus on succession planning, the board believes that it is the right time for a transition in leadership as the company executes a strategy to achieve enhanced operational focus and profitable, long-term value creation," Elysia Ragusa, chairman of the company's governance and nominating committee, said in the release.

DIGITAL BANKING

Smaller branches, more versatile staff: Citizens Bank's new normal

By Penny Crosman
May 22, 2020

Even before the coronavirus pandemic locked down much of the economy, Citizens Financial Group, like many banks, had been shrinking its branch footprint and transforming existing branches into "advice centers," where customers go for financial guidance rather than to complete transactions that can otherwise be done through digital channels.

CEO Bruce Van Saun says these trends will only accelerate now that customers, out of necessity, have become more comfortable depositing checks remotely using their mobile phones. He sees the role of branch employees evolving as well, with some moving to virtual locations and being trained to provide a broad range of services and others taking on more specialized roles advising wealth management clients and business owners.

"Those are the kinds of things we're thinking about that are a little bit out of the box," Van Saun, who is also chairman of the $177 billion-asset company, said in a recent interview with American Banker.

Van Saun and his leadership team are also spending a great deal of time thinking about how to safely bring employees who have been working remotely since March back to Citizens' corporate campus near its Providence, R.I., headquarters and other offices throughout the country. They are considering a range of options, though Van Saun says no employees will be required to return to work until they feel they're ready.

What follows are Van Saun's views on what Citizens' new normal will look like. The interview has been edited for clarity and length.

Are you seeing this pandemic change the way banking is done across the board, and if so, how?

BRUCE VAN SAUN: I do think there will be changes. I think the individuals who have moved to greater use of digital like the convenience. They avoid having to take a trip to the branch to deposit a check. They've realized they can just take a picture on their smartphone. So I think you'll see less foot traffic in the branches, and that has implications for how we run our channels. We need more digitization of the bank and better digital tools. We may not need as much physical distribution. We've been on this path already. We've been turning our branches into advice centers, with nicer facilities, smaller meeting rooms and upskilling the folks that we have in the branches who can be knowledgeable about multiple products and providing advice. This is going to be accelerated, based on the events of the past couple of months.

When you say you're going to do more upskilling of people in the branches, do you know what that will look like or what kinds of new skills and maybe new jobs those people might get?

I'll give you one example. In our contact centers, we had outsourced certain simple questions, like password resets, to offshore centers. When the pandemic hit globally, many of those centers were shut down. We took our branches, where we had reduced the hours, and rapidly trained those people up to bolster the contact center. They have to have fairly broad knowledge about what our overall objectives are, what our products are and be in a position to offer advice.

What we're thinking about now is, should we even bring back those offshore centers? If we're not going to need as much physical presence in the branches, should we put some of those branch-based people into virtual centers where they can do outbound contacting of customers? Those are the kinds of things we're thinking about that are a little bit out of the box. How do we maintain that connection virtually if we're not going to have as much interaction physically in the branch.

You mentioned turning branches into advice centers. What will those be like?

That's been an ongoing program for us to create specialties in areas like wealth and small business. People who are generalists in the branches are now getting training to offer specialized advice. So you're trying to put those folks in a position where they can have productive conversations with people on life's journey and try and help them meet life's challenges and offer our full set of products and services.

When you think about leading through a crisis, what do you think are the keys to keeping everything running smoothly when there are so many changes – for instance, Citizens built a new lending platform for the Paycheck Protection Program in 11 days, it crafted forbearance programs – during a time when most people are working from home?

I think it starts with having a great leadership team that are all on the same page and aligned with what needs to get done. There's a high level of trust with the leaders, because I as CEO can't be everywhere all the time. So having folks who have been through the wars before, have good judgment and can react to or anticipate situations and then convene the group as needed to discuss what they're seeing, that's been a key. And then, just having flexible thinking in terms of, we've got a challenge here, what are the different ways that we can tackle that challenge? And being able to pivot resources.

For example, with PPP, we knew that this was going to be big and it was going to be really important to customers to get them their lifeline. And it was going to be important to us and our reputation that we were able to secure the funding. If we were shut out, it really wouldn't look good for us as an organization. So we said, "Let's pull some of our best people across the bank, regardless of where they are [and]make sure things are going in the right direction."

How do you look at reopening for Citizens? Are you in a hurry to get people back into offices and back into branches as soon as you can? Do you feel more cautious about that? Do you think that there might be roles that just stay work-from-home permanently?

We'd like to participate in the reopening of the economy, but go at the pace that the individual states allow us to go. So we've had plans for every state. We're going to follow social distancing. We'll bring people back probably in thirds, one week on, two weeks off.

We're only going to invite people back to work. It's not going to be compulsory. There are a lot of folks who are itching to get back to work. There are other folks who are still quite fearful or have health conditions that they're a little worried about coming back to the office. So we're going to take that into account.

But I do think there are advantages to having our people who now are working remotely come back into the office, be able to interact with their fellow colleagues and collaborate and challenge each other and generate good ideas. That helps maintain the social fabric and the culture of the company. It may not be that we have everybody come back. We may have some people work three days in the office, two days off, so we still have the requisite amount of social distancing. I'm in favor of opening the economy smartly, and then bringing our people back in a smart and prudent fashion.

APIS

Coronavirus put Truist's innovation plans on fast track

By Paul Davis
May 21, 2020

Truist Financial is preparing for the next phase of the coronavirus crisis.

The $506 billion-asset company, formed by the December merger of BB&T and SunTrust Banks, took some big initial steps in response to the pandemic.

It committed $25 million in mid-March to help communities hurt by COVID-19, and it also received approvals for $12.6 billion in small-business loans under the government's Paycheck Protection Program.

Truist has pledged another $25 million for nonprofits and volunteer efforts, investments in technology for communities that lack high-tech infrastructure, and small businesses and community development financial institutions.

During the crisis, Truist has learned how to deliver services quicker and more efficiently, says Dontá Wilson, the Charlotte, N.C., company's chief digital and client experience officer.

New tech products that would have taken months to create are being produced in as little as three days. More customers, especially commercial clients, have grown comfortable with digital banking, while thousands of Truist employees have settled into work-from-home arrangements.

"We're constantly evaluating" Truist's operating model, Wilson said in an interview. "One of the silver linings of the crisis is seeing how to deploy our staff remotely when needed."

Wilson discussed Truist's latest financial commitment, along with his views on technological innovation in the wake of the coronavirus outbreak. This is an edited transcript of the conversation.

Why did Truist decide to double its coronavirus commitment?

DONTÁ WILSON: We were excited to see the benefits of our initial round of investment. After 22 days the commitment was oversubscribed. You can't just watch things like that transpire and not help more.

We also realized that this crisis was going to go on longer than what many people originally thought. There are four stages: an immediate need, an emerging need, a resiliency period and rebuilding. [Assistance] tends to disappear during the last phase, so we started thinking about what would be important as we rebuild.

We realize that small businesses are particularly vulnerable, so we wanted to make sure we dedicated $10 million for technology services and grants with a focus on women- and minority-owned businesses.

We were happy with the progress bridging the tech gap in [underserved communities], but the need was highlighted during the COVID-19 pandemic. We're going to empower communities, many of them rural, to recover. We're encouraging solutions for [out-of-school] learning while trying to rebuild the landscape permanently.

Our employees wanted to be active volunteers, but they're limited by social distancing. So we committed to making a contribution for every mile our employees walk [during the pandemic]. Many galas and nonprofit events have also been postponed, and we want to help those groups in their time of need.

How has the pandemic changed Truist's approach to innovation? How much of that change will represent a permanent shift for the company?

When we did the deal, it was a merger of equals designed for something more than just cost cutting. We really wanted to move forward meaningfully with innovation by combining touch and technology to develop a high level of trust. We moved digital, data analytics and other functions under the same umbrella.

COVID-19 advanced and accelerated our effort to build technology road maps. … We created a client-experience digital control room that met every day. We partnered with businesses to roll out solutions in days. We built a mortgage chatbot and converted and digitized the manual forms for mortgage forbearance in four days.

Before PPP, we didn't have a digital portal. We had to make one work for two heritage systems. We developed a customer [application programming interface] in the middle of this and expanded e-signature for people remotely. None of these initiatives took more than 10 days to build and most were created in three to four days.

That's how we're going to do work going forward. We'll work with the client and be agile to do in days what used to take six to nine months.

What did the pandemic do for digital adoption rates? Do you think new adopters will continue to use digital channels when the crisis passes?

We were already seeing digital transactions improving year over year, but COVID-19 has us moving down an accelerated path. You had people who started using their computers to log on to review account balances, then they started using mobile check deposit services. They have become more engaged, seeing the convenience and wondering why they would go back to [in-person banking]. It is similar to my experience with grocery pickup. I had never used it before, but I've come to really like it.

And I think we've done a good job of educating people about digital banking, including a simulator on our website to get them comfortable with our products and services.

How effective has work from home been? Other Truist executives have discussed using the model more when things normalize.

We have fantastic teammates. The environment and location doesn't matter to them. Their commitment has been on fire. They figured out how to be successful even when they were working remotely.

We're constantly evaluating the [model]. One of the silver linings of the crisis is seeing how to deploy our staff remotely when needed.

Any other crisis-related takeaways that you think will be permanent fixtures at Truist?

We've experienced a new way of doing work, discovering how to co-create in days versus months and years. The crisis also accelerated the bonding necessary to create a new culture. It allowed employees from both [predecessor banks] to see what we're about in terms of providing tutoring [for their children], flexible work schedules and child care assistance.

When you're rolling out your brand, you want to tell your story. You come into it with a whole agenda in mind. COVID was not in the plan. But our customers' first interaction will be through this experience, and that will stand out for them. I think that's a permanent thing that will link us to our communities.

CARES ACT

Senate bill would ban garnishment of relief funds by debt collectors

By Neil Haggerty
May 24, 2020

WASHINGTON — A bipartisan group of senators has introduced legislation to prevent debt collectors from garnishing coronavirus relief payments from consumers.

Sens. Sherrod Brown, D-Ohio, Ron Wyden, D-Ore., Chuck Grassley, R-Iowa, and Tim Scott, R-S.C., have sponsored legislation that would bar private debt collectors from garnishing the "recovery rebates" that were provided to consumers through the Coronavirus Aid, Relief, and Economic Security Act.

"Congress came together to pass the CARES Act, which provided money to help working families pay for food, medicine, and other basic necessities — it's not for debt collectors," Brown, the top Demcorat on the Senate Banking Committee, said in a press release. "Our bill will protect these funds and ensure working families receive the help they need."

Grassley added that Congress intended for the rebates to help Americans weather the pandemic.

"We established these recovery rebates to help individuals and families through the tough times of this pandemic," said Grassley, who chairs the Senate Finance Committee. "We did not establish them just so debt collectors could swoop in and undermine that purpose."

The CARES Act provided individuals up to $1,200, along with an additional $500 for any dependent children. The legislation barred federal or state governments from offsetting or reducing the payments for past tax debts or other debts owed. But it didn't prevent private debt collectors from garnishing the payments for unpaid debts.

The new legislation directs the Treasury Department to encode electronic payments so that banks can identify and protect these payments from being garnished by debt collectors.

For payments sent in paper form, such as a check, the bill allows individuals to request that their banks protect the payments from being garnished by debt collectors and authorizes the financial institutions to do so.

CAPITAL

Pandemic prompts banks flush with capital to raise more

By Jim Dobbs
May 22, 2020

For all the talk about the banking industry being well capitalized, a number of banks aren't taking any chances during the coronavirus crisis.

Several dozen banks have raised capital since COVID-19 was declared a global pandemic. Some are raising capital to provide an extra buffer for credit losses. Others are stocking up now for potential acquisition and lending opportunities.

More banks are expected to turn to investors in coming months.

OceanFirst Financial in Toms River, N.J., has raised capital twice in the past month, issuing subordinated debt on April 29 and preferred stock two days later. While there is a defensive reason, the $10.5 billion-asset company also wants to be ready to expand when the crisis passes.

"Typically, on the back side of any period of stress, there's strong demand for credit," said Christopher Maher, OceanFirst's chairman and CEO.

"Banks have an opportunity to play important roles in recoveries," Maher added. "I do think there will be acquisition opportunities again going into 2021. The additional capital opens up our strategic options."

Banks in general are finding receptive investors and reasonable pricing. Low interest rates have also provided an opportunity to affordably raise capital by issuing senior and subordinated debt.

That may not always be the case, industry experts said.

"It's times like this that banks are reminded it can be really smart to raise capital before you need it," said Jacob Thompson, a managing director of investment banking at SAMCO Capital Markets.

"The markets are open now, but you really don't know when that door will slam shut, given all the uncertainty," Thompson added. "I can tell you more banks are looking at this, and regulators, generally, are of the mind that the more capital the better."

Capital hasn't been a problem for banks in recent years.

The total risk-based capital ratio for all banks was 14.63% on Dec. 31, according to the Federal Deposit Insurance Corp. That was an improvement from 12.77% at the end of 2007, when banks were heading toward the financial crisis.

If the steep and sudden downturn drags on for several quarters, capital needs will mount across the industry — with the possible exception of banks that are extremely well capitalized, said Jon Winick, CEO of Clark Street Capital.

"We may have a long way to go," Winick said. "There's a lot more that we don't know than we do about this thing."

A survey of 104 bankers conducted by D.A. Davidson as part of its virtual conference in early May found that nearly one in five expect to raise capital over the near term.

"That's significant," said Russell Gunther, an analyst at D.A. Davidson. "I think the real number could even be higher than that. I suspect some bankers are not quite ready to check the box on raising capital but will get there before long."

An overwhelming majority of bankers who participated in the conference expect steep loan-loss rates and a protracted economic slump that likely will extend through much of this year — or beyond.

Against that backdrop, even companies with solid capital levels are bound to need more, or would stand to benefit from having more on hand when conditions improve.

"A lot of banks are focused internally now — on their balance sheets and where there could be losses," Gunther said. "I think that some really strong, very well-capitalized banks could take advantage of the lack of competition. It could be an incredible time to take market share."

Hilltop Holdings in Dallas raised about $200 million in subordinated debt earlier this year. Before pricing the offering, the $15.7 billion-asset company intends to be among the banks benefiting from an eventual recovery, Hilltop President and CEO Jeremy Ford said.

"I think first and foremost, we're going to continue to be patient and work on our own businesses," Ford said during the company's earnings call. "When the environment presents itself, we're going to be very aggressive."

Larger banks also are boosting capital levels, including Citizens Financial Group, Fifth Third Bancorp and Regions Financial.

The $178 billion-asset Citizens and its bank each priced a $750 million offering of senior debt in late April.

"Maintaining a strong capital and liquidity position is of paramount importance in managing through this stress period," Bruce Van Saun, Citizens' chairman and CEO, said at a recent conference.

Citizens also wants to forge ahead with growth initiatives, including investments in digital platforms and payments offerings.

"Our philosophy here at Citizens is to keep making those investments, not to pause, but look to drive top-line growth and come out of this period stronger relative to our peers," Van Saun said.

PAYCHECK PROTECTION PROGRAM

SBA issues guidance on PPP loan forgiveness

By Paul Davis
May 24, 2020

The Small Business Administration and Treasury Department quietly issued more guidance for the Paycheck Protection Program as legislators look to make more fixes to the emergency loan program.

One of the interim final rules, issued late Friday night, focused on the requirements for having PPP loans forgiven. The other rule provided direction on lenders' duties during the forgiveness period, along with the SBA process for reviewing loans.

Banks will be required to issue decisions on borrowers' forgiveness applications within 60 days after receiving them. The SBA said it would then pay the lenders within 90 days.

The SBA stated that it has the right to review any loan, though it will evaluate them based on the "rules and guidance available at the time of the borrower's PPP loan application." The agency said it is preparing a separate rule to lay out an appeals process for borrowers.

Lenders will lose the fees for any loans deemed to be ineligible, and the SBA said it could claw back already issued fees. The rules also outlined more qualifications for payroll expenses and established limits for how much loan forgiveness is available for owner-employees.

Bankers seemed unimpressed with the latest guidance, which did not extend the amount of time borrowers have to use the funds beyond its current eight-week period. The rules also did not reduce the payroll requirement, which currently stands at 75% of PPP funds.

"Just another Friday night where [SBA and Treasury] continue to muddy the … water to make it as complicated as possible to obtain forgiveness and bankers to manage it," Brad Bolton, president and CEO of Community Spirit Bank in Red Bay, Ala., tweeted on Saturday.

Several other bankers quickly agreed with Bolton's assessment.

"They had us make a bunch of loans to businesses that don't qualify with the old 'don't worry' and now it's on us," said Ken Clayton, chairman and CEO of Western Bank in Artesia, N.M.

Legislators, meanwhile, are considering bills that would give borrowers up to 24 weeks to deploy PPP funds and allow them to spend more than a quarter of the money on nonpayroll expenses. The Senate and House have different proposals under consideration.

CREDIT FRAUD

Experian launches synthetic identity detection service

By Penny Crosman
May 22, 2020

The credit bureau Experian is launching a service called Sure Profile that it says will help banks detect synthetic identities before lending to, or opening accounts for, fraudsters.

Synthetic identify fraud, where crooks invent realistic-seeming identities out of scraps of real ones (for instance, one person's Social Security number, another's mailing address) has plagued banks for years. Cybercriminals typically use a synthetic identity to establish credit that they then use responsibly for an average of six years before going dark. Lenders often never realize they gave money to a fraudster with a fake identity. All they know is that they have a loan in default that they eventually charge off.

Aite Group estimates this type of fraud costs U.S. lenders $10,000 to $15,000 per incident. Auriemma Insights estimates the losses are $6 billion annually. According to McKinsey consultants, 85%-95% of loan applicants identified as potential synthetic identities are not flagged by traditional fraud models.

"Synthetic ID fraud has been on the rise for years," said Alex Lintner, group president for consumer information services at Experian. "It puts both lenders and consumers at considerable risk."

When a lender who subscribes to the Sure Profile service pulls a credit report, the company will quickly conduct a series of data checks and apply machine learning to the data to determine if the applicant is a real person. The process is necessarily fast: Experian's service-level agreements with lenders often require response rates that are measured in milliseconds. Experian issues about 2 million credit profiles a day, or 700 million per year.

Several other vendors, including ID Analytics and LexisNexis Risk Solutions, as well as the credit bureaus Equifax and TransUnion have offered technology for detecting synthetic IDs for some time. Lintner said Experian has filed several patents covering its methodology, which he declined to describe in detail but said involved the use of data assets other companies lack.

"Our gestalt as a corporation is different than other bureaus, and therefore these other data assets don't exist in our two major competitors," Lintner said.

Experian will pay a bank for any losses that come from a synthetic identity that the company verified as real. However, because it's almost impossible to verify that a credit loss came from a synthetic identity, the lender has to trust Experian to report its own error well after it has made its determination.

One question is, are credit bureaus best qualified to do synthetic identity checks? In the Consumer Financial Protection Bureau's complaint database, the largest category of complaints consistently relate to credit bureaus. So far this year, 73,728 people have complained about the credit bureaus, and 51,624 of those gripes have been that there was incorrect information in a report.

Lintner said Experian has a system for fixing errors in credit reports that he compares to a robot vacuum.

"We find those errors through analytical methodologies, and we eliminate them," he said. "We've gotten kudos from the CFPB."

CFPB

CFPB offers templates for banks, servicers to seek 'no-action' letters

By Kate Berry
May 22, 2020

The Consumer Financial Protection Bureau took steps to help banks gain approval for offering small-dollar installment loans and to enable mortgage servicers to use an online platform for loss-mitigation efforts.

The bureau released an approved template for banks to use in seeking a CFPB "no-action letter" — designed to allow companies to develop products without fear of supervisory action — to offer installment loans or lines of credit for amounts of up to $2,500. The template was requested by the Bank Policy Institute, a Washington trade group.

The bureau's action came two days after four federal regulatory agencies released new guidance on how banks and credit unions can offer small-dollar loans without raising regulatory concerns.

The agency also approved a template requested by the Los Angeles-based Brace Software for servicers to seek "no action" approval to use the firm's platform for homeowners applying online for loss mitigation.

While the bureau does not endorse specific products or providers, the templates provide parameters that it has approved. Companies can use the templates to get speedy approval of their own no-action letters to receive a safe harbor from regulatory actions taken by the CFPB.

Brace provides a white-label, digital loss mitigation platform that adheres to timelines set by the Real Estate Settlement Procedures Act and provisions of the Fair Debt Collection Practices Act.

The Bank Policy Institute's template envisions products structured either as small-dollar installment loans or open-end lines of credit that specifically exclude the risky features of payday loans such as high-cost fees and repeat rollovers that trap consumers in cycles of debt.

The institute's template explicitly excludes deposit advance loans and loans made in conjunction with payday lenders.

Alex Horowitz, a senior research officer at the Pew Charitable Trusts' consumer finance team, said small installment loans and lines of credit from banks "would create a much better option for the millions of households that today use high-cost loans outside the banking system."

Last year, the CFPB allowed trade groups and service providers to submit templates that provide specific guidelines or parameters for products and services. Banks and financial firms are expected to then apply to the bureau for a no-action letter using the templates.

BANKTHINK

OCC was right to finalize CRA rule on its own

By Faith Bautista
May 22, 2020

This week marked a major milestone in financial regulation after the comptroller of the currency significantly revamped the Community Reinvestment Act, a 1977 law that requires financial institutions to meet the credit needs of their communities but has barely been updated since its enactment.

Despite disagreements over the final rule, to anyone paying attention, it had become extremely clear the CRA's objectives of helping low- and moderate-income (LMI) communities had become stifled by outdated regulations, which failed to keep pace with technology and the transformation of how banks deliver services.

With the coronavirus pandemic and its multiple adverse impacts on many communities, CRA modernization could not have come at a better time.

Coronavirus quarantines have shaken up the economy and there's an expected a fluctuation in the general market of services. Many small businesses are in need of financing and resources. With these uncertainties, LMI neighborhoods need the innovation encouraged by the new CRA regulations now more than ever.

But updating this critically important law did not happen overnight. The Office of the Comptroller of the Currency spent many years of consideration and meetings among regulators, industry members, community-based organizations and others to adopt a more modern CRA that better achieves the law's worthy objectives.

There are four key areas of the newly revised CRA:

It clarifies and expands what qualifies for CRA credit as well as expanding where CRA activity counts.

It also provided an objective method to measure CRA activity, and revises data collection, recordkeeping and reporting.

These changes will improve the ability of community-based organizations to advocate for their communities, and hold the less-engaged financial institutions accountable for meeting their CRA obligations.

The economic impact of the coronavirus pandemic has disproportionately affected LMI communities and people of color. This modernized CRA comes at a time when African Americans have the lowest percent of homeownership and other minority communities, such as Latinos, have been most affected by the economic fluctuations. An additional $100 billion investment will certainly help people and neighborhoods in need.

With the updated CRA regulations in place, it will reduce the accountability issues that have hampered the efforts of community-based organizations, and result in more creative and effective solutions for lending and the needed investments to help LMI communities. The modernized CRA regulations bring flexibility while remaining true to the law's original intent to benefit underserved communities.

While some community groups disagree with the OCC's final version, it should instead be seen as a first step in the right direction to getting CRA up to speed. This is a law that hasn't been significantly changed since the 1990s, before online banking and without consideration of a pandemic that would cripple the well-being of neighborhoods. It's critical we do something now, instead of continuing to do nothing.

Hopefully the move by the OCC to take the lead on this issue will spur other federal bank regulators to take similar steps forward to better achieve the CRA's goals.

Faith Bautista is the founder and president of the National Diversity Coalition.

SMALL BUSINESS LENDING

Fed's Rosengren sees Main Street loans within next two weeks

By Bloomberg News
May 24, 2020

Federal Reserve Bank of Boston President Eric Rosengren said he expects companies to begin receiving money through the central bank's long-awaited Main Street Lending Program within two weeks.

"This is a program that's just starting up, so we're expecting to have the loan documents up this week," Rosengren said Sunday on CBS's "Face the Nation." He added, "We then have to register the banks, and then we're going to be ready to start issuing the loans."

"Money will go out over the next two weeks," he said.

Lending facilities

The Boston Fed is administering the Main Street program, part of the emergency lending effort announced by the U.S. central bank to keep credit flowing in the economy during the COVID-19 pandemic. It's designed to provide up to $600 billion in credit to small and medium-sized U.S. companies.

Fed Chairman Jerome Powell and Rosengren had said in recent days they expected it to become operational by the end of May. The Fed first announced its intention to create the program on March 23 and has been under increasing scrutiny over its slow launch.

"We've been working on it very hard over the last several months," Rosengren said. "I expect it will be a relatively smooth opening."

Main Street is one of nine Fed emergency lending programs opened or under construction that are aimed at mitigating the economic impact of the virus.

Asked about the pandemic's impact on the labor market, Rosengren said he doesn't expect a rapid rebound in employment this year.

"Unfortunately, I think it's likely to be double-digit unemployment through the end of this year," he said. "Getting back to the low level of unemployment we saw at the end of February probably takes either a vaccine or other innovations that make it much less risky to go out."

Rosengren also repeated his view that more government support for the economy will be necessary.

"We need to continue fiscal and monetary policy, because double-digit unemployment risks actually a much more severe outcome in labor markets over time," he said.

SMALL BUSINESS LENDING

Millions of PPP loan-forgiveness requests are about to rain on banks

By Bloomberg News

May 22, 2020

Banks are preparing for a flood of applications for loan forgiveness under the U.S. Paycheck Protection Program, marshaling staff to help borrowers navigate a complicated process that recalls the fraught early days of the COVID-19 small-business relief effort.

Companies that received PPP funding in early April can start to submit forgiveness applications at the end of May. Lenders will have to help them sort through a detailed application document, complete the paperwork and get it to the Small Business Administration for approval. Banks made about 4.3 million PPP loans for a total of more than $500 billion, and the program allows every borrower to request forgiveness.

At Valley National Bancorp in Wayne, N.J., 500 employees out of its 3,200-person workforce were designated to help customers process the loans, and a similar number will probably be needed to deal with forgiveness requests, CEO Ira Robbins said. Valley National has issued more than $2.2 billion in PPP loans.

"Hopefully it doesn't all come at one time and we can stagger it over a period of time, but I do believe there's going to be a lot of hand-holding associated with it as you walk through it," Robbins said in an interview.

The SBA released an 11-page document last week listing the criteria small businesses must follow to get their PPP loans forgiven. Among the guidelines are directions on how to calculate payroll costs, which must account for 75% of loan proceeds spent.

The document is complex, so it will fall to lenders to help borrowers complete it, said Libby Morris, head of U.S. operations at Funding Circle Holdings, a London-based firm that issued PPP loans.

"I would equate this to just as heavy if not a heavier lift to processing the loans themselves," Morris said. "You pretty much have to build a new loan funnel and reprocess all of these loans again. For most lending businesses, you may be doing this full time for no revenue."

Piermont Bank, which made PPP loans in the greater New York City area, has spent hours deciphering SBA requirements to create a worksheet for borrowers, CEO Wendy Cai-Lee said in an interview. PayPal Holdings, a provider of about $1.6 billion in PPP funding, plans to use online tools to streamline the forgiveness process, Doug Bland, senior vice president of global credit, said in an email.

For all the planning by lenders, the rules could still change. Next week, the House is set to vote on a proposal that would relax the 75% payroll requirement and give businesses more time to pay back loans that aren't forgiven.

Businesses are still looking for clarity on whether employee bonuses and some health insurance and retirement plans count as payroll, said Joan Vines, a managing director at BDO USA, who has been advising borrowers. Confusion was also prevalent during the original loan-approval process, when lenders complained about a lack of guidance from the SBA.

Many businesses may find they fail to meet SBA terms for forgiveness, which will leave banks with loans to service and customer issues to resolve, said Josh Knauer, general partner at JumpScale, an anvisory. He estimates that 50% of PPP loans won't be forgiven.

"I see going forward that lenders, all types of lenders, are going to have a massive customer relations problem with the companies they're lending to," Knauer said. "More time will have to be spent on the phone, more audits are going to have to be done, and a lot more digging into every single line item of expense."❑