AMERICAN BANKER®

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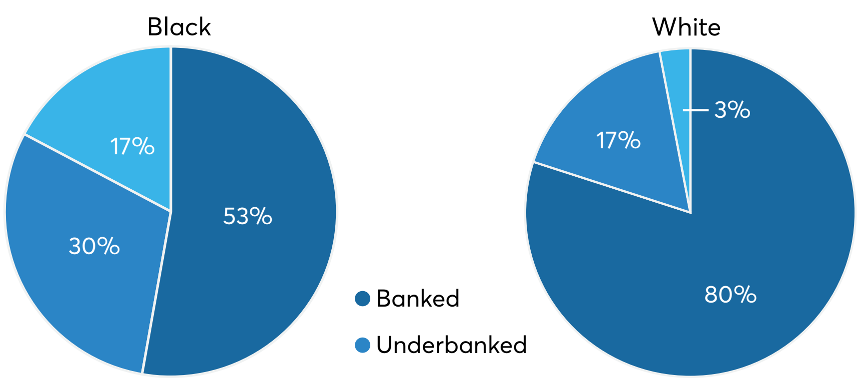
Where help is needed

47% of Black households are unserved by banks or have limited access, compared with 20% of White households. Large deposits in Black-run banks could help do more to close that gap.

See story on page 3



Source: McKinsey & Co., FDIC (data from 2017)

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A New York CDFI is halfway to its $100 million fundraising goal for a fund that would put deposits in Black-owned banks and make loans to key businesses or projects. It hopes the moves will improve availability of capital and access to mainstream financial products. (See chart above.) **Page 3**

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COMMUNITY BANKS

Why banks are reinstating share repurchase programs

By Jim Dobbs
September 07, 2020

Share repurchase programs, paused earlier this year due to regulatory pressure and the banking industry's desire to conserve capital during a period of uncertainty, are regaining momentum.

More than a dozen community banks have authorized buybacks, or reinstated previously suspended programs, in the past two weeks. Others will likely follow over the rest of this year, industry experts said.

"We think COVID and macroeconomic challenges will ultimately prove manageable for banks, which should then catalyze the resumption of, or announcement of, new buyback authorizations," Hovde analyst Joe Fenech said in an Aug. 31 note to clients.

Fenech's note followed an announcement by Investar Holding in Baton Rouge, La., that its board had approved the repurchase of 300,000 shares, adding to the 62,000 shares remaining under an existing authorization.

Investar's announcement is "a likely harbinger of similar-type actions to come from community banks in the months ahead," Fenech added. Such measures "offer a measure of support for the stocks that has obviously been absent for most of the past several months."

Shore Bancshares in Easton, Md., and First Interstate BancSystem in Billings, Mont., recently reinstated their programs. HarborOne Bancorp in Boston, Mid-Southern Bancorp in Salem, Ind., and Eureka Homestead Bancorp in Metairie, La., are among the banking companies to approve new plans.

Share repurchases can help banks signal a belief that their stock is undervalued.

Investar's shares, for example, are down about 40% this year, more than its earnings are down. The $2.4 billion-asset company's second-quarter EPS of 39 cents was down 19% from a year earlier.

Buybacks are also an efficient way "to increase shareholder value and earnings per share," said John D'Angelo, Investar's president and CEO. Earnings per share rise because the buyback reduces shares outstanding.

Regulators required the biggest banks to put buybacks on hold until at least the final quarter of this year. Most smaller banks followed suit amid concerns that an economic malaise would lead to a spike in bad loans, higher credit costs and reduced capital.

The amount of money spent on buybacks across all industries fell by 55% in the second quarter from a quarter earlier, to $90 billion, according to preliminary data from S&P Global Market Intelligence.

Loan deferral rates have begun to improve roughly six months into the pandemic and most banks still have strong capital levels. With bank stocks still under pressure, more management teams and boards are ready to revisit repurchase activity.

Recent history supports the strategy.

Over the past decade, the S&P 500 Buyback Index, which gauges the equal-weighted performance of 100 companies with the highest buyback ratios in the S&P 500, had an annualized return of 13.6%. The return for the overall S&P 500 was 11.2%.

Historically, banks are second only to technology firms in industry buyback activity.

The $4.5 billion-asset HarborOne announced one of the biggest buyback programs in recent weeks, disclosing on Thursday that its board had authorized the repurchase of roughly 2.9 million shares, or 5% of its outstanding stock.

The $16.5 billion-asset First Interstate said in August that it had lifted a temporary suspension of its previously announced stock repurchase program — paused because of the pandemic. It can now buy back about 1.5 million shares, or about 2.2% of its outstanding stock.

First Interstate's move signals confidence in current conditions and an "improving economic picture," Jacquelynne Bohlen, a Keefe, Bruyette & Woods analyst, wrote in a client note. She said a resurgence in coronavirus cases or new shocks to the banking industry could lead to another pause.

To be sure, there is headline risk tied to resuming buybacks, especially for industries that have had a perceived benefited from government intervention during the pandemic, said Preston Gelman, an analyst at IHS Markit. Still, he said, investors "have an appetite for repurchases given the signal of balance sheet strength such an action would send to the markets."

While buybacks imply a more positive view of the market, uncertainty still exists. That could deter a large wave of buyback announcements, at least in the near term.

A heated presidential election, as well as uncertainty about the duration of the pandemic and further federal aid, continues

AMERICAN BANKER.

Established 1836
One State Street Plaza, 27th floor, New York, NY 10004
Phone 212-803-8200 AmericanBanker.com

Editor in Chief Alan Kline 571.403.3846
Managing Editor Dean Anason 770.621.9935
Executive Editor Bonnie McGeer 212.803.8430
Washington Bureau Chief Joe Adler 571.403.3832
Executive Editor, Technology
Penny Crosman 212.803.8673
BankThink Editor Rachel Witkowski 571.403.3857
Community Banking Editor Paul Davis 336.852.9496
Contributing Editor Daniel Wolfe 212.803.8397
Digital Managing Editor
Christopher Wood 212.803.8437

Copy Editor Neil Cassidy 212.803.8440

Reporters/Producers

Laura Alix 860.836.5431, Kate Berry 562.434.5432
Miriam Cross 571.403.3834
Jim Dobbs 605.310.7780
John Heltman 571.403.3847, Allissa Kline 716.243.2679
Hannah Lang 571.403.3855
John Reosti 571.403.3864, Gary Siegel 212.803.1560
Jackie Stewart 571.403.3852, Kevin Wack 626.486.2341

to hang over the economy, said Scott Brown, chief economist at Raymond James.

"To maintain earnings, firms may resort to further job cuts in the months ahead, which would dampen the pace of the recovery," Brown said. "State and local governments are experiencing significant budget strains, which will likely also lead to job cuts."

CAPITAL REQUIREMENTS

Fed corrects stress test error for Morgan Stanley, Goldman Sachs

By Hannah Lang
September 04, 2020

WASHINGTON — The Federal Reserve on Friday said there was an error in the calculation of the capital requirements for five banks that were subject to stress tests this year, which affected the capital requirements for Morgan Stanley and Goldman Sachs.

The central bank said it had miscalculated the loss rates for certain public welfare investments, which resulted in "an overestimation of hypothetical losses for those investments."

To correct the error, the Fed updated the common equity Tier 1 capital requirements for Morgan Stanley and Goldman Sachs to 13.2% and 13.6%, respectively, down from 13.4% and 13.7%.

Citigroup, HSBC and Wells Fargo were also affected by the error, but the capital requirements for those firms remain unchanged.

The Fed has instituted changes to prevent similar errors to the calculation of capital requirements in the future, and also conducted reviews of its other models used as part of its stress tests, which found no other errors, the agency said.

Even with the updated capital requirements, Morgan Stanley and Goldman Sachs will still have the highest requirements out of the 34 largest banks that the Fed supervises.

Goldman Sachs had appealed the Fed's stress test results after they were published, but the Fed had turned down that appeal, along with appeals from BMO, Capital One, Citizens and Regions.

DIVERSITY AND EQUALITY

Can multimillion-dollar pledge to Black banks help close wealth gap?

By Laura Alix
September 04, 2020

A New York community development financial institution has raised $50 million for a fund aimed at supporting Black-owned banks and steering more capital into minority communities.

The Local Initiatives Support Corp. said it plans to make deposits in Black-owned banks and provide financing to minority businesses later this year with the money raised in its Black Economic Development Fund. The big-box chain Costco recently committed $25 million to the fund, following a $25 million pledge by Netflix that seeded the initiative. LISC said it plans to close its first $100 million this fall.

LISC launched the fund this summer as a way for private companies to help close the racial wealth gap. The CDFI said it already has identified $30 million of potential deposits it could make at specific Black-run banks or loans it could directly extend to certain businesses and projects.

George Ashton, its managing director of strategic investments, said the funds deposited at Black-owned banks will have direct and indirect impacts on the communities they serve. Not only will the money allow those banks to make more loans within their neighborhoods, but it will also enable them to offer financial education and other resources more widely, he said.

"Those banks are often key players in the community," he said. "Our goal is to infuse capital into the banks with deposits but also participate with them directly in transactions that benefit the community."

Widespread protests after the death of George Floyd and the pandemic's outsize effect on minorities have motivated private-sector companies to act. Bank of America, PNC Financial Services Group, U.S. Bancorp and Huntington Bancshares have made multipronged, large-dollar commitments to address racial inequities.

CDFIs and minority financial institutions will play a key role in connecting those big-dollar pledges with the people, businesses and community development projects that need them the most.

Increasing access to mainstream financial services is critical to closing the wealth gap, many experts say. Forty-seven percent of U.S. households are unbanked or underbanked, compared with 20% of white ones, according to a McKinsey & Co. study that drew on data collected by the Federal Deposit Insurance Corp. in 2017. Increased access to basic banking services could save Black Americans up to $40,000 in check-cashing and other fees over the course of their lives.

Yet the number of minority depository institutions has declined to 143 as of the second quarter from 197 a decade ago, and Black-owned banks have particularly suffered since the financial crisis. Minority depository institutions collectively held $280 billion in assets as of June 30.

Citigroup agreed to purchase up to $50 million in Paycheck Protection Program loans from minority-owned banks, allowing those smaller institutions to free up capital and also keep the loan fees. Comerica in Dallas said it will deposit $10 million with minority-run banks, and PayPal deposited $50 million in the $155 million-asset Optus Bank, a minority-owned institution in Columba, S.C.

Many large banks had also already zeroed in on CDFIs as critical to getting emergency aid to small businesses even before the civil unrest precipitated by Floyd's death. Minneapolis-based U.S. Bancorp, for instance, backed Black-led CDFIs early into the pandemic and has said those partnerships will be key to carrying out its $116 million pledge to address systemic racism.

It will be a tall order, to be certain, but industry officials and outside experts say that closing the wealth gap between Black and white families will benefit society more broadly. One study estimated last year that it could add $1.5 trillion to the U.S. economy.

Ashton said he expects LISC to raise the remaining $50 million for the fund with large pledges like those made by Netflix and Costco. He said similar commitments are "waiting in the wings."

"There's a social-consciousness awakening that this is a problem and its sources are systemic racism," he said. "Exclusion of these communities from the financial system has really created problems that are bad for our society."

CLEARINGHOUSES/ CUSTODIANS

BNY Mellon takes a step toward a future without passwords

By Ryan W. Neal
September 04, 2020

Imagine never having to type a password to access your digital workstation again.

That's the future BNY Mellon Pershing envisions. Financial advisors can now access the custodian's NetX360 desktop using fingerprint and facial-recognition capabilities on an Apple device, with support for Android devices planned in 2021.

Beyond convenience, biometric authentication can help advisors be more secure, said Michelle Feinstein, Pershing's director of technology and client engagement. By using fingerprints and facial-recognition technology instead of traditional passwords, advisors can stop using words and phrases that can be easily guessed, written down in unsecure locations (like Post-it notes on the side of a screen) or stolen in phishing schemes.

"This moves [advisors] away from having to remember all the time what their password is and type it into their desktop," Feinstein said.

Advisors will still need a secure, written password to access the desktop the first time and enable biometric login. They will then get a link sent to their mobile device to authenticate either their fingerprint or face. After that, advisors only need to use the mobile login to access their desktop, though they will have to change the core password every 60 days for security, Feinstein said.

While Pershing is starting with logins, the firm has plans to eventually use biometric authorization for additional processes, such as getting client authentication for asset movement.

"I do think that biometric's popularity is going to continue to grow," Feinstein said, especially as it becomes more ubiquitous in consumer technology.

As many as 66% of wealth management clients say they prefer biometric authentication to the use of traditional passwords, according to research firm Celent. Wealth management firms are looking to invest more in external software and services, and biometric authentication is a top short-term priority.

Pershing already supports fingerprint and facial-recognition logins on its client portal, but hadn't previously brought the technology over to advisors. Providing this type of functionality is especially important in a post-COVID-19 world where both advisors and clients are increasingly remote, Feinstein says.

Fidelity Institutional also supports biometric authorization for clients to access the Wealthscape Investor portal. A spokesperson said it is on the company's technology roadmap to bring this over to advisors as well.

In 2019, Cetera Financial Group revealed plans to use facial recognition software to analyze client emotions as they fill out a risk questionnaire to help advisors better understand how they think and feel about their money. Cetera did not immediately respond to a request for comment on these capabilities.

"You're starting to see different major players think about how they can move towards a password-less experience," Feinstein said. "This is one step forward towards that. In the future, I think we can get there."

COMMUNITY BANKS

Bancorp 34 CEO Jill Gutierrez announces retirement

By John Reosti
September 04, 2020

Bancorp 34 in Alamogordo, N.M., will soon have just one president and CEO.

The $457 million-asset company said in a press release Friday that Jill Gutierrez, who shares the titles with James Crotty, will retire at the end of September. Gutierrez, who was 69 when the company filed its proxy statement in late May, will remain on the board.

Crotty, a former director at Keefe, Bruyette & Woods, was named co-president and co-CEO six weeks ago. While at KBW, Crotty advised community banks on a variety of strategic initiatives, including capital raising and acquisitions.

Gutierrez, who has worked in banking since 1972, joined Bank 34 in 2007. She became the company's president and CEO in July 2011.

Under her leadership, Bancorp 34 entered the Phoenix market, buying the $87 million-asset Bank 1440 for $8 million in cash and stock in August 2014. Two years later, Gutierrez led Bancorp 34's second-step conversion.

Bank 34 exited mortgage lending in May 2019.

The company has made 277 Paycheck Protection Program loans, totaling $36.1 million.

"We wish Jill an enjoyable and family-filled next chapter and are happy she will continue to serve by our side on the Board," Bancorp 34 Chairman Randall Rabon said in Friday's release. "She was instrumental in leading the bank out of the Great Recession and served as our leader in strengthening the culture and credit standards we enjoy today."

CHECKING

Some digital payment innovators still see value in checks

By Kate Fitzgerald
September 04, 2020

Business-to-consumer payments are rapidly shifting to digital channels, replacing paper checks with a variety of instant-payment methods for gig work and corporate reimbursements.

While most of these solutions aim to completely replace slow, costly paper checks, certain providers recognize that some portions of the U.S. population remain wary of instant payments, especially for one-time payouts of refunds and insurance payouts.

A couple of these companies have found a way to bridge the gap by layering the familiar imagery of paper checks over digital payment platforms.

Longtime check-printing giant Deluxe is using this hybrid route in its own transition to digital payments with the Deluxe Payment Exchange. An email notifies recipients of available funds with instructions to access Deluxe's platform to print out a check for deposit, or accept a virtual account or ACH deposit directly to a bank or PayPal account.

San Mateo, Calif.-based Checkbook.io also leans heavily on paper check nomenclature and imagery, sending B2C payments via a text or email that opens to look like a check made out to the recipient.

"We're getting rid of checks but we're doing it in a way that retains the convenience of paper checks because that's what many people still know and trust," said PJ Gupta, Checkbook.io's founder.

Launched five years ago, Checkbook.io has gradually built a following with corporations doing mass disbursements, mostly for one-time refunds or class-action lawsuit payouts. Whirlpool Corp. has used Checkbook.io's services for mass payouts, Gupta said.

This month, Checkbook.io joined the Visa Fintech Fast Track program to speed up its development. As part of the move, Checkbook.io has added virtual cards to the list of payout options so recipients can opt to receive funds via ACH, check printout, virtual prepaid card or instant bank account deposit through Visa Direct.

Checkbook.io is taking a somewhat unique path in a sector that's bursting with competition and innovation, according to Sarah Grotta, director of debit and alternative products advisory at Mercator Advisory Group.

"There are many fintechs in the 'mass pay' arena offering platforms for B2C rebates, refunds, gig worker and payroll-like payments and a lot of banks are developing similar services within their cash management platforms," Grotta said, noting that many platforms support cross-border B2C payments.

PNC recently launched Direct to Debit Card, a B2C solution targeting corporations for traditional payroll processing paying on demand and independent contractor payments.

In recent years, digitization of B2C payments has sharply reduced overall volume in the sector. B2C checks account for about 40% of total check volume, according to Federal Reserve data.

"The reality is that corporations doing mass payouts need to address all different types of customer preferences if they want to fully connect," Gupta said.

The largest number of Checkbook.io's end users typically opt for ACH payouts because it's familiar and trusted, while a smaller number actually choose to print out a check. But virtual card payouts are gaining rapid adoption, according to Gupta.

"We're seeing an accelerated adoption curve for virtual cards as more customers look at all the choices and realize a digital card payment means they can get their funds right now," he said.

Under Visa's Fast Track program, Checkbook expects to expand its services to reach banks, insurance companies and new vertical industries interested in white-labeling the disbursement payouts in the form of a check, Gupta said.

"Digital checks aren't new, but we're building new and different features, such as a walletless system for push payments, to make B2C payments more effective," Gupta said.

PURCHASING POWER

Higher home prices cancel out increased affordability: Redfin

By Brad Finkelstein
September 03, 2020

Low mortgage rates boosted consumer home purchasing power in July by nearly 7% compared with one year ago. However, rising prices caused by the inventory shortage has negated that, according to Redfin.

Thanks to a 30-year fixed rate mortgage that stayed in the 3% range during July (which remains that loweven now), a potential buyer with a housing budget of $2,500 per month could afford to buy a home priced at $516,500. That's up from the $483,250 they could afford on the same budget in July 2019.

But home prices rose by 8.2% on a year-over-year basis in July, Redfin found. As a result, 70.6% of homes nationwide were affordable on a $2,500 per month housing budget, down slightly from 71.9% one year prior.

"Low mortgage rates are motivating many people to purchase a home, particularly those who want more space to work from home," Redfin Chief Economist Daryl Fairweather said in a press release. "But because therehasn't been an increasein the number of homes for sale since rates started dropping with the onset of the pandemic, many buyers end up competing for the same homes, driving up prices.

"Those competing forces make the current market a wash for many buyers looking for single-family homes in competitive areas," Fairweather said.

And perhaps some of those would-be buyers are losing heart. The week-to-week data released by HouseCanary indicates that the purchase market is slowing. New listings dropped 6.5% for the week of Sept. 3 compared with one week prior. While this was down 26% from the week of March 13, which is considered the start of the pandemic shutdown, they are up 16.2% from the low point for the week of April 17.

At the same time, the volume of listings going into contract is down 5.8% on a week-to-week basis.

"The sustained supply deficit, lifting of COVID-19 precautions in several states and the devastating effects of natural disasters across the country have created impending risks that are difficult for potential homebuyers to ignore," said HouseCanary CEO Jeremy Sicklick in the report. The slight pullback of home sales activity over the past few weeks may reflect early signs of a seasonal shift in demand as the initial surge of pandemic buying weakens.

"While we do not see a significant leveling out or dramatic shift in the supply-demand imbalance in the third quarter of 2020, the potentialexpiration of forbearance programsin early 2021 has the potential to catalyze a surge in distressed home sales, which would likely take some of the heat off home prices," Sicklick said.

CORONAVIRUS

As school year starts, credit unions on campus brace for a slowdown

By Aaron Passman
August 27, 2020

Credit unions chartered to serve colleges and universities could see traditional fall-semester membership gains decimated because of the coronavirus.

The start of the new academic year is often the biggest time of the year for recruiting new members, thanks in part to the influx of new students on campus. But many schools have had to alter their plans for the new semester because of the ongoing pandemic. The University of North Carolina in Chapel Hill initially had students on campus for in-person instruction but reversed course after one week. Similarly, Michigan State University switched gears at the last minute and moved to online-only courses shortly before students were set to return from summer break.

Several universities that had made plans for in-person coursework this fall have seen spikes in COVID-19 diagnoses with students back on campus. The University of Alabama reported roughly 560 cases during its first week of classes, while the University of Kansas saw 222 positive tests in just two days.

The National Credit Union Administration lists about 50 credit unions chartered to serve colleges and universities, and institutions serving those groups are doing their best to roll with the punches.

"Your strategic plan kind of went out the window on March 15," quipped Daniel Berry, CEO of Duke University Federal Credit Union.

"From a student perspective, I think a lot of schools had the best of intentions," he added. "They thought they could control it [with online classes in the spring, masks and social distancing] and kind of underestimated that teenagers want to be together. That's part of the college experience."

Duke CU serves some of the student population but is more targeted at faculty and staff. It normally sees about 100 new members per month, but that figure dropped by more than half when quarantine started in the spring. Things have improved to the point that new memberships are now up to 60 or 70 per month.

"Now you can't put a tent up [in areas where students congregate], you can't say, 'Here's a t-shirt if you join us.' Everything's online," said Berry, noting that other tactics such as geofencing also don't work without the influx of people on campus. "You've got to adapt, but still your results are going to be lower than normal."

Berry said it's still unclear what sort of expectations the credit union should be setting since it's so difficult to predict when things will get back to normal.

Achieving last year's averages "may be an unrealistic target for 2020," he said.

Michigan State University FCU normally onboards between 25% to 30% of the university's incoming student population, an average of about 2,300 new members each year between May and September.

This year's numbers are only at about 50% of the usual target.

"There's normally about 50 different events we'd be at [on campus] and now the majority of those have been cancelled or… moved to a virtual setting," said Deidre Davis, chief marketing officer at the $5.4 billion-asset institution. In instances where new-student orientation and other activities have been moved online, the credit union has in some cases been asked to provide a video to introduce MSUFCU and some basic information on financial wellness.

While upwards of 30% of the new student population may seem impressive, Davis said those numbers pale in comparison to 15 years ago when the credit union regularly had 80% or more of each year's new class join.

"Back then you needed to have checks from a local financial institution, and with the advent of mobile banking people didn't need to close one account and open another," she said. "The rise of debit cards…made access to that previous financial institution so much easier, and so not as many students felt that need to have that local account."

The credit union still gets significant

mileage out of school spirit and connection to the university, including debit cards and checks with pictures of campus and the school's mascot. Still, the number of new memberships each fall has dropped by about 10% in each of the last few years, and "this pandemic is causing a much greater decrease in the number of accounts," Davis said.

As of the end of July, Michigan State University FCU membership was up by almost 5.3% year over year, but year-to-date growth was just 2.3%. Assets have risen 22.1% year-to-date and deposits were up more than 23%.

Davis noted that some of MSUFCU's hit to new memberships will be blunted by recent expansion efforts, including new branches across the state in the towns of Holt and Traverse City. Membership is open to state employees and a variety of other select employee groups.

Sam Brownell, CEO at the consultancy CU Collaborate, pointed out that this sort of scenario exemplifies why diversified fields of membership are important.

"Having a diverse field of membership has its pros and cons [but] one of the pros is that you have a more diversified risk exposure in terms of who your members are and things that could impact them," he said.

Along with the hit to membership growth, Davis said MSUFCU may also see a reduction in what it forecasted for interchange income, since fewer new members means fewer new credit and debit cards issued. Management had budgeted for a 5.5% increase in debit interchange but is now expecting just 5% growth.

The picture for credit interchange is worse. Current plans predict just a 4% increase for that revenue stream compared with the 19% originally expected.

Berry and Davis both suggested 2021 may also be a challenge. Berry noted that even breaking even financially may be enough to call the year a success, in part because 2020 had two and a half months of "normal" activity before the pandemic hit.

Davis said MSUFCU has increased its digital marketing in order to reach members — including alumni along with faculty, staff and students — who aren't on campus, but said expansions into other parts of the state in recent years could help with growth.

Brownell cautioned that even if CUs serving universities are eventually able to make up for the business they would have gained this year, it's likely to come at a cost.

"Can you attract new members, deposits and loans through digital strategies from students who otherwise would have seen you in a branch? Definitely," he said. "But will you be able to make everything up in terms of meeting your projections? Probably not. You'll have to spend more money on digital marketing than you would have otherwise."

OPINION

Fannie, Freddie lessons learned: The folly of the GSE profit sweep

By Michael Delehanty

September 02, 2020

This Sunday marks the 12th anniversary of Fannie Mae and Freddie Mac entering into conservatorship. Perhaps the only thing more shocking than that action back in September 2008 is the fact that 12 years later the government-sponsored enterprises are still in conservatorship.

Nothing more exemplifies the myriad reasons for this lack of progress than the GSE profit sweep. In 2012, a few federal officials mandated that all GSE profits would be continuously stripped from the GSEs. This was done without any congressional or public debate through changes to the Preferred Stock Purchase Agreements governing federal financial support of the GSEs. The result has been a relentless siphoning off of profits, preventing the GSEs from building up capital or accumulating reserves for a rainy day.

The profit sweep was quietly cheered on by the large Wall Street banks, who benefited from this roadblock to administratively ending the conservatorship. This shifted the focus to congressional action, where they could pursue their goal of new guarantors, which would allow them to use their secondary market dominance to gain an unfair advantage in the primary loan origination market (vertical integration).

And the profit sweep was quietly cheered on by GSE opponents, who hoped zero capital would make it easier to eliminate the GSEs or reduce their footprint. Finally, the profit sweep was quietly cheered on by those who understood that the diverted profits could be used for spending on non-housing purposes. Congress even passed a bill requiring GSE guarantee fees to be raised 10 basis points and used exclusively for non-housing uses.

In contrast, the profit sweep was denounced by the Community Home Lenders Association and other small lender and affordable housing groups. We knew that it was just a matter of time before housing markets turned down and the lack of capital or reserves would have negative consequences. Five years ago, the CHLA even proposed putting the swept GSE profits into a capital reserve account, which could have been used to cover future GSE losses. Unfortunately, our proposal was not adopted.

Sure enough, with COVID-19, the proverbial chickens have come home to roost. Federal Housing Finance Agency Director Mark Calabria recently explained that the pandemic is creating billions of dollars of GSE losses that he argues need to be addressed through repricing of risk. The result has been actions like the earlier 7% GSE penalty for purchasing loans in forbearance and the recently announced (and delayed) 50-basis-point adverse market fee for refinance loans.

Without the profit sweep, or with the reserve plan the CHLA had proposed, none of these fee hikes would have been necessary. Of course, the GSEs' financial shortfalls would be even worse, necessitating even more severe actions, if Director Calabria had not commendably lifted the profit sweep shortly after taking office, allowing the GSEs to build up some modest reserves in the intervening period.

But all this is the past and can't be changed. The question going forward is what lessons we learn for the future. First, the surreptitious 2012 changes to the PSPAs demonstrate that all parties that care about GSE reform need to pay close attention to a potential next round of changes to the PSPAs. The administration's housing finance plan proposes using this vehicle to carry out certain changes, including language to ensure equitable access to smaller lenders. The CHLA supports that approach and recently wrote a letter stressing the need for broad, permanent bans on any GSE discrimination based on size or volume, as well as how our organization believes a utility model should work.

Second, Congress should fund the relatively small amount of money it would take to reverse the GSE fee increases and penalties put in place in response to the coronavirus. Congress and the Federal Reserve have provided trillions of dollars to support the economy since COVID-19 hit. Surely, Congress can return a small portion of the nearly $110 billion in net profits Fannie and Freddie have generated for taxpayers as a result of the profit sweep to protect homebuyers and owners.

Finally, the profit sweep and the pandemic raise important questions about the proper role of Fannie and Freddie in a post-conservatorship world. The 10-basis-point g-fee diversion expires in 2021; should Congress let it expire? (The correct answer is yes.)

Should we pursue policies designed to shrink GSE market share, even though that will reduce consumer mortgage access to credit? Should the GSEs be regulated by the FHFA under a utility model and if so, what pricing and product regulatory authorities should that agency have?

As the FHFA moves administratively toward an end to the GSEs' conservatorship, we need a vigorous public debate on these key issues. The folly of the GSE profit sweep shows what can happen when we fail to do that.

Michael Delehanty is president of the Community Home Lenders Association and chief financial officer of Mountain West Financial, based in Redlands, Calif.

BANKTHINK

How Congress can prevent a post-pandemic financial crisis

By Blaine Luetkemeyer and William M. Isaac
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"Everyone is convinced that accounting standards are simply too boring and too intricate for anyone to pay attention to."

Those were the opening remarks of Rep. Brad Sherman, D-Calif., during a House Financial Services subcommittee hearing earlier this year with accounting standards officials. Sherman, a CPA and the chairman of the subcommittee, is absolutely right. To most Americans, accounting is boring and appears too menial to spend time reviewing.

However, when looking at the astonishing impacts accounting standards have on the U.S. and world economy, everyone would be well served to resist glazing over the rules, and pay close attention to what's brewing in Norwalk, Conn., where the Financial Accounting Standards Board is headquartered.

Paying close attention, however, is not sufficient. FASB is a self-appointed private entity operating with impunity and virtually no supervision from Congress or the federal financial regulators. Congress must act soon to ensure the Securities and Exchange Commission and other financial regulators have proper oversight of this powerful, private-sector organization.

Lack of oversight of FASB has resulted in devastating impacts on the nation's economy in the past and will continue to do so in the future if safeguards are not enacted soon.

In late 2007, financial institutions were forced to implement FASB's so-called mark-to-market accounting standard, which required banks to account for the fair value of an asset based on the current market price.

What FASB failed to consider was the effect this accounting standard would have on macroeconomic conditions. So when the financial crisis hit in 2008, institutions were forced to write down nearly $2 trillion in assets, causing banks across the country to shut down and creating the largest loss of personal wealth in world history.

In a reluctant recognition of the damage done by the mark-to-market standard, FASB reconsidered it in 2009 and proposed more appropriate guidelines on how to value assets.

Just a decade later, financial institutions are facing another unprecedented situation due to the economic shutdown caused by the coronavirus pandemic.

And once again, accounting standards officials and regulators are poised to make the situation much worse. In a similar fashion to the mark-to-market standard, FASB in 2016 issued its current expected credit losses, or CECL, accounting standard, which requires financial institutions to estimate and then reserve immediately for the anticipated lifetime losses of a loan. It basically requires banks to predict and reserve against losses spanning as much as 30 years into the future for mortgages.

Just like 2007, FASB issued this standard with no economic study of how CECL would affect the economy or access to credit for consumers and small businesses.

The CECL standard is exacerbating the current downturn and resulting in financial institutions dramatically increasing their reserves, taking billions of dollars out of the economy. This ultimately means consumers and small businesses will have considerably less access to credit.

Fearing a repeat of 2008, Congress included a provision in the recent coronavirus relief package allowing financial institutions to suspend the implementation of CECL. Bank regulators also issued an interim rule preventing CECL from impacting the regulatory capital of banks for two years. It should be noted that FASB opposed both efforts.

While these are good measures, Congress should come to the same realization that industry, stakeholders, investors and regulators already have: The CECL standard does not work, is incredibly damaging and needs to be eliminated.

A House bill (HR 7914) was recently

introduced to do just that. Not only does the bill ensure the ill-advised accounting standard does not wreak any additional havoc on the economy, it will be a no-cost injection of capital into the economy through providing relief to the institutions that have been forced to drastically increase reserves.

While eliminating the CECL standard is essential to preventing the government from hampering the recovery — or making matters even worse — simply doing no harm by ending it is not enough.

Congress and regulators must take proactive measures to ensure financial institutions are able to assist America's small businesses and families in righting the ship.

In order to do that, financial institutions must have the flexibility to work with customers whose accounts have been harmed by the virus and subsequent economic shutdown. Without forbearance for institutions, examiners will have very little alternative other than to force financial institutions to negatively classify loans and even write them off entirely.

Banks will not be legally allowed to work with their customers but instead be forced to cut their losses and leave consumers, who have fallen on hard times through no fault of their own, out in the cold.

In response, a second proposal called the Financial Institution Forbearance Act is a bipartisan bill that allows depository institutions to move assets that were modified due to the coronavirus impact to a separate account on the balance sheet where it will not be criticized by examiners or accountants for a temporary period of time.

This additional time will also give families, businesses and banks time to work together to stabilize these loans and allow hardworking Americans to get back on their feet. Without it, we will almost certainly experience the collapse of local markets resulting from wholesale shutdowns of lines of business, as seen in the 2008 recession. This bill protects the economy from further damage without spending a penny of taxpayer money.

The resiliency and ingenuity of the American economy can overcome any obstacle put in its way. However, regulation and complacency should not be allowed to slow the economic rebound. Congress must act to allow financial institutions to help their customers and save the thousands, if not millions, of jobs at stake.

These bills are easy solutions that will not only help banks, businesses, local communities and millions of hard-working Americans, but it will be a catalyst for economic recovery once the pandemic is behind us.

Congressman Blaine Luetkemeyer represents the Third Congressional District of Missouri and serves as Ranking Member of the House Financial Services Subcommittee on Consumer Protection and Financial Institutions.

William M. Isaac, a former chairman of the Federal Deposit Insurance Corp. and Fifth Third Bancorp, is co-chairman of the Isaac-Milstein Group. ❑