

CAPOCO

2020 CARES ACT

SMALL BUSINESS ADMINISTRATION LENDING

HOW DOES THE CARES ACT IMPACT YOUR OVERALL PORTFOLIO?

Overview

Signed into law on March 27, 2020, the CARES Act provides broad relief to consumers and small businesses. The Act incentivizes regional and community banks who serve these clients to support these groups. While they prepare to support their clients in this effort, they should consider current portfolio implications as well.

The Current Landscape for US Banks

Banks of all sizes face unprecedented challenges in the current climate, with both commercial and retail lines of business (LOBs) affected. Change drivers include the following:

- COVID-19 and rapid business shutdown in March has negatively impacted almost all business sectors
- Title IV of the 2020 CARES Act, Economic Stabilization and Recovery, allocates \$500 billion in loans, loan guarantees, and related transactions across targeted industries, states/municipalities, medium-size businesses and non-profits
- Due to this, banks are seeing tremendous growth in SBA lending, while deteriorating market conditions are negatively impacting their counterparties
- Low-interest rates before the shutdown have compressed NIMs, with the Federal Reserve cutting them to virtually zero
- During Q1 2020, record unemployment across the U.S. portends a recession, impacting all sectors
- In parallel with these trends, recent market selloffs have impacted both assets and liabilities, compounded by near-term liquidity concerns



CARES Act and Bank Portfolios

- Regional and community banks, faced with an unprecedented demand for SBA lending at a time of substantial market activity and limited operations, face some specific impacts on current portfolios

Impacted LOBs	Cares Act Specific Impact	Cross Portfolio Impact
PPP-Eligible Lending Mortgage Student Loans	<p>Student Loans</p> <ul style="list-style-type: none"> The Act prohibits negative credit reporting by lenders/servicers for six months <p>Portfolio Reporting</p> <ul style="list-style-type: none"> Amends Fair Credit Reporting Act to change how creditors report borrowers in forbearance <p>PPP and SBA Reporting</p> <ul style="list-style-type: none"> SBA payout is triggered by the lender's expected loan/loan pool to be forgiven <p>PPP and Bankruptcy</p> <ul style="list-style-type: none"> Eases bankruptcy hurdles for borrowers impacted by COVID-19 	<ul style="list-style-type: none"> Securitization pipeline for mortgages may experience disruption, but the expectation is that government-sponsored entities (GSEs) will further relax origination standards Across business lines, current date loss reserves will likely understate Q1 losses Securitization pipelines for auto loans and credit cards will likely slow due to tranche under-performance
Non-PPP C&I CRE Auto Loans Credit Cards	<ul style="list-style-type: none"> These are excluded from CARES Act, so are not eligible for support under the Act 	

- While regionals and community banks evaluate existing LOB performance, they can benefit by considering the overall market impact on their current counterparties for downstream effects

Counterparty	Potential Impact
Custodians	<ul style="list-style-type: none"> Impact on increased general transaction volumes, staffing and facility constrictions, cash and collateral management Increased volatility in margin disputes and thresholds is likely, possibly driving volumes in equity derivatives and RPAs
Broker-Dealers	<ul style="list-style-type: none"> Potential increased interaction with internal Treasury in driving hedge strategies Higher overall trading flow may impact individual bank's presence in the execution queue
Swap Dealers	<ul style="list-style-type: none"> Expect higher demand for balance sheet protection across all counterparties and assets Renewal of existing deals, such as IR and CDS, may require less favorable terms
Contingency Providers	<ul style="list-style-type: none"> Assume higher drawdown and less favorable terms

- While banks implement the CARES Act, they must maintain their existing business lines to the extent possible
- Near-term expectations of bank performance should be adjusted with shareholders, as senior management looks strategically throughout 2020

CAPCO IS READY TO HELP ...

Our firm has demonstrated expertise and experience assisting clients with:

- LOB performance monitoring and reporting, as well as regulatory reporting
- Developing ramp-up plans including staffing, processes, workflow, and operational rules, and workflow
- Operationalizing loan forbearance and forgiveness tracking and execution
- Staff augmentation/distributed workforce support

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