Conversations with the Fed

4/24/20

11:30 a.m. – 12:00 p.m.

Jim Fuchs:

Welcome, everybody, to what has become during this crisis our every-Friday Conversations with the St. Louis Fed. As those of you who have joined us before are aware, this is a program that we have offered since 2011 to connect with state member banks and the Federal Reserve Eighth District. Let me just ask any of my colleagues who might not be on mute if you could do that, please. Thank you.

So we've had this program for a number of years, using it to connect you directly with our staff to talk about supervisory matters. We feel like it's important to maintain regular communications through a lot of different forms with our state member banks. During this pandemic, however, we thought weekly half-hour calls would be a great opportunity for you to submit questions to us and for us to let you know what we're hearing and offer our thoughts on some of the things that we're seeing in our portfolio of banks here in the Eighth District. So if you joined us last week, you heard an economic update from Bill Emmons, and his notes are posted on last week's Conversation.

We also provided an overview of the Paycheck Protection Program Liquidity Facility. A number of questions have been received on that, and our general counsel at the St. Louis Fed, François Henriquez, discussed the documentation requirements and just some of the language on one of those documents that raised a couple of questions for state member banks.

All of our sessions are recorded and archived, and so if you missed any of that, please go back to the archives. That's available to you, and certainly, any follow-up questions, please reach out to us at conversations@stls.frb.org. I will also say we are monitoring that throughout this call, throughout the week, throughout the weekend. So as things arise, things you would like us to discuss on this call, or even if you have a call directly for someone on our staff, we can always get your question to the appropriate person.

So with that, I'm going to turn it over to our senior vice president in charge of banking supervision here at the St. Louis Fed, Carl White. Carl?

Carl White:

Thanks, Jim, and welcome, everyone, again. Another Friday. Just a couple points. Conversations, this program, is targeted specifically toward state member banks in the Eighth District, but we certainly welcome others that may join. I know we do invite our members of our CDIAC council, and we also invite our state counterparts as well. But this is specific to the Eighth District.

Just a couple thoughts I'll share with you. Here in St. Louis, and both from a System perspective, we're already starting to put together what we're calling a return-to-work framework. I have no details to share with you other than we're already having those discussions to try to prepare ourselves. And I just mention that as just a reminder to you and your boards of directors, if you haven't started that already, I think it's a good time to start having those conversations, so that we're prepared.

The last thing I'll mention is, I've mentioned this before, but if you go the federalreserve.gov website, I've mentioned there's a separate section for COVID-19. I know this week there's been at least three or four press releases, updates to existing programs, and some expansion of some programs. You can also sign up for email pushes so that you'll get the emails directly sent to you if there's any updates, and with as many updates as it seems that we have in a given week, I just kind of recommend that to you.

So that's really all I have for opening comments. So I'm going to turn it over to Bill. I know many of you have heard Bill speak not just here, but you've also seen him on the Take Five sessions that we record throughout the year. I guess this is turning into a Take Five live. But Bill's joining us again this week; Bill's an officer in Supervision, but he's also our go-to economist for issues, and he's agreed to talk to you again this week. So I'm going to turn it over to Bill.

Bill Emmons:

Thank you, Carl.

I would like to spend just a few minutes talking about the economy, where we are, look a little bit at our district, and then look at financial and commodity markets briefly. So I want to start again by just putting us in this context. Things are moving so fast. When did the economy turn south? Well, there's a lot of information really becoming available. There's an index from the Philadelphia Fed that now shows that business conditions were beginning to soften in January, and by the end of February, business conditions were deteriorating pretty rapidly across the country.

Remember, long-term bond yields dropped 50 basis points in the last two weeks of February, and the Fed made an emergency rate cut of 50 basis points on March 3 and then cut another 100 basis points on Sunday, March 15, taking the short rate back to zero. It was then in the next week the labor market began to collapse. That's the week of March 16, and only then did governments begin to order people to stay at home after the economy already was in freefall. Federal guidelines on social distancing, for 15 days originally, were issued on March 16 and then we got stay-at-home orders March 21 in Illinois, March 24 in Indiana, March 26 in Kentucky, the 31st in Tennessee, April 3 in Mississippi, April 6 in Missouri. Still no order from Arkansas. So by the end of March, the economy was in freefall virtually everywhere in the U.S., and we were locked down across much of the country.

So in terms of what was happening in our district, in general terms, our economies are following the nation with a little bit of a lag. Among the Eighth District states, unemployment in Missouri seemed to be following the nation most closely in the beginning stages of this crisis. And now, after we have three weeks of data at the state level of collapsing job markets, Kentucky has had the largest increase in its unemployment rate among our district states, and it's in fact increasing even faster than the national rate overall. All of our other district states are trailing that U.S. deterioration, and the lowest increases in unemployment have been in Indiana, Arkansas, and Mississippi.

So where are we right now? Looking again back at the national picture, the New York Fed has an index of weekly economic—and daily—indicators that they put together, and they now are estimating that the real GDP number, economic growth is about 12% down from a year ago, and that would compare to a 4% decline at the worst point in the Great Recession. As for unemployment at the national level, we'll get the April unemployment estimate, which is actually taken in the week containing the 12th of the month, that will be released on May 8. And the estimates range from 10% to 20% or even higher.

And for putting that in perspective, unemployment at its worst point in the Great Recession was 10%, and in the Great Depression it was 25%. So we're somewhere in that range, probably between the Great Recession and the Great Depression already in April.

So let me say a little bit about financial markets. I think this contrast is very interesting. It's continuing the contrast with the economy, which still is very, very bad. The financial markets have been functioning pretty well. That's certainly the large-scale interventions by the Fed and the Treasury beginning in March and continuing really indefinitely are the most obvious reason for that. If you look at the forward-looking information implied by financial market prices, I read it to say that we are not heading into an economic depression, but we are certainly in a recession now. And I say that because the stock market is cautiously optimistic, I would say. The S&P 500, for example, is down about 15%, which is not depression-type levels compared to the beginning of February before things really started to fall apart. But the VIX indicator of stock market volatility is still about twice its normal level, so that's where the caution comes in.

If you look at the long-term interest rates, as you know, very, very low, and I think that's suggesting investors are expecting pretty slow economic growth and low inflation for quite some time. In terms of commodities, the ag commodities and livestock are mostly lower than they were two months ago. Cattle, corn, and cotton down the most among the set of prices I looked at, while rice has actually rallied. Energy prices are down across the board in a wide range. Natural gas is actually about unchanged from early February. Ethanol is down 30%. Oil is down well over 60%. And of course you saw this week that bizarre negative oil price that occurred for one day for one contract.

So wrapping it up, I think the economy is still contracting at this point, perhaps at a decreasing rate of decline. Most economists, I think, still hope the second quarter will be the low point, with growth returning in the second half of 2020. And overall, the financial market signals are cautiously optimistic I would say, but nonetheless uncertainty, volatility remain elevated. So a reasonable expectation is we could see economic recovery in the second half of 2020, but there's still a high risk of economic and financial volatility this spring and summer.

I'll leave it at that and turn it back to you, Carl.

Carl White:

Thanks, Bill. Okay, we're going to keep moving. Next we're going to have Kathy Paese. Kathy is executive vice president and product manager of the Treasury division here in St. Louis, and some of you may not realize but the Treasury division at the Fed here is actually our largest division.

Supervision is second, and that's based on number of headcount, but the Treasury function provides significant support from an operational perspective to several Treasury services, and Kathy oversees that entire operation. So you may have heard her name mentioned on a couple of our Ask the Fed sessions in the last couple weeks that we held on the economic impact payments. So I'm going to turn it over to Kathy, and she's going to give us some comments and common questions regarding this program.

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So, Kathy, turn it to you.

Kathy Paese:

Thanks, Carl, and good afternoon, everybody. It's nice to be with you here again. I know for some of you, I've participated in the prior Ask the Fed sessions on economic impact payments or EIPs, as we are referring to them. So I wanted to just give you a quick update on where we are in processing all of those payments and then also provide just a few answers to some common questions that have come through on a variety of fronts, including the Ask the Fed sessions.

So prior to this weekend, the Treasury and the Federal Reserve have processed two waves of payments of these economic impact—or EIP—payments. Two weeks ago was the first wave; that was about 82 million payments that went out, for about $146 billion. We had a second, smaller wave of payments that went out last weekend. Those were the first checks that were issued in addition to many millions of ACH payments as well.

And so we are beginning to work right now on the third wave of payments that will come through this weekend from the IRS. We don't have a firm count yet on the number of payments that will be issued this weekend and will begin to hit financial institutions early next week, but I would put it in the ballpark of 15 to 20 million payments. The vast majority of those will be ACH. So Treasury anticipates that after we get through this third wave that we're working on now and over the weekend that they will actually have originated about 120 million of the total 160 million payments that they expect to originate as part of the CARES Act, these economic impact payments. So that's about two-thirds or three-quarters of the payments that they expect to be issuing.

So going forward after this week and weekend, we anticipate that there will be smaller, weekly waves of payments that will come out from IRS and Treasury. They're anticipating between five to seven million checks a week could go out, depending on the demand and, honestly, depending on the number of people who go into the IRS websites and enter in their information.

And so I did want to mention that briefly, both of the IRS portals are up and running that enable people to go out and check and see where the status is of their payment or where they can enter in their banking information. The two websites: irs.gov is the primary website, and there's a link within the first one called Get My Payment. And this is where people who normally file their taxes can go to find out the status of their payment and if it's been issued yet or whether it's yet to be issued. And there's also on that website a separate link for non-filers where they can go out and check on the status of their payment.

But we learned earlier this week that about six million Americans have gone out and used these websites to enter in their banking information. And that's really fabulous, because that's six million people who will get their payments electronically and will not have to get a check and potentially wait a little bit longer to receive their economic impact payments.

So I did want to share that Treasury is very appreciative of all of the support that they have received from financial institutions around the country to post these payments quickly to their customer accounts. I did want to mention one question or observation that we've heard from bankers here in the last week. That is, Treasury is originating with IRS all of these payments; they're usually being delivered by the Fed to financial institutions either over the weekend or on Monday, but the actual settlement date for those payments—the ACH payments—is usually on Wednesday of that week, and if it's a check payment, the settlement days have been on Friday of that week. And Treasury's done that to just accommodate their internal processing that they have to do to get the payments out the door. And they wanted to make sure that financial institutions knew that if they did cash a check or deposit it prior to that settlement date, that money will not be returned. That's fine. Financial institutions can go ahead and process those payments and make those deposits prior to the settlement date, and Treasury will be compensating them accordingly.

I also wanted to mention here that due to the time constraints on the part of the IRS and Treasury to try and get as many of these payments out as quickly as they could, they really were not able to make any internal systems changes to uniquely identify these payments. So I think we've shared in prior Ask the Fed sessions that these payments are being processed just like tax refunds. And so in the ACH file, it looks like the payments are coming through as a tax refund. They were able to make a minor modification for the check payments that are now coming through and to indicate that it is an economic impact payment and it does have the president's signature on it. But all of these payments are to be handled and processed just like you would any other ACH payment or tax refund payment that's come through from the Treasury.

And at this point, I did want to encourage all of you financial institutions to utilize the Treasury Check Verification Application or TCVA. This is an application that banks and credit unions can use to look up checks to see if the check has been issued, if it's been cleared, and it's a way to identify potentially fraudulent checks that could be out there. The TCVA application, you can get to it at the following website. It's tcva.fiscal.treasury.gov. And again on this particular site, there's also information about security features that are on each of the Treasury checks, and those are important things for you to look at when you're getting checks in and processing them. And then Treasury is also working on an API or an interface that large banks can use if they want to submit a bulk file with check numbers in it to ping against the database and see if they've been cleared or not. That is not ready yet. It was hopefully to be ready today, but I think that will be ready hopefully sometime next week. But that is coming for larger institutions that want to be able to validate more than one check at a time.

So I've just got a minute or two left. I wanted to address a few additional questions that we've gotten over the last couple of days. So the first relates to deceased payees and closed accounts. Those are different things, but they've in some cases been related. So just like you would handle any other ACH payment, if you receive in an economic impact payment that's destined for an account that is closed, then all of those transactions should be returned back to Treasury. For deceased payees, we have run into several situations where an ACH payment has been delivered to an account where it was a joint account and one of the account holders is alive and the other is deceased, and in that case, you would process that just like you would any other ACH payment because the account is open and it's considered a valid account.

Now, a third question that we've received has to do with third-party payments. And we saw in one particular case where some individuals had gone to a tax preparer and received a refund, a tax refund anticipation loan and so they received what would have been their tax reimbursement directly from that financial institution. And so when their economic impact payment was delivered, it was delivered to that financial institution and not directly to the individual.

Those cases have been resolved in a number of ways. In some cases, the financial institutions have returned those payments back to Treasury. That's completely fine. We've had other institutions where they've actually looked at the Social Security number in the payment and then identified their individual account holders and been able to apply those payments based on the Social Security number. And then we did have one particular instance where a number of payments were sent to a financial institution, and that financial institution actually wrote checks out or created checks out to the ultimate end users or receivers of those payments as they should have been originally issued.

I know that's a little confusing, but I did want to make people aware that we understand this situation existed; it's fine to return those payments back to Treasury and IRS, and they will work to get them to the right individuals.

So, Carl, I will finish there and leave it at that. Thanks very much.

Carl White:

Thank you, Kathy. Great information. And I know both Kathy and I mentioned the Ask the Fed sessions you can go to; those are archived. More information, more questions are answered on those. And I'm sure Jim will make sure that all the links that she mentioned and all that information is available to you.

So with that, we continue to reach out to all of all of you—either Allen North or Scott Smith, or some of the portfolio examiners, or Jim Warren for our regional organizations. I'm going to have Allen maybe give us some comments and thoughts on what we've been hearing from you and maybe some updates on some of our procedures.

Allen North:

Sure. So good afternoon, everybody, and Carl mentioned that the Fed is looking at a return-to-work framework and mentioned the importance of thinking about that and what the impact's going to be on all of you. First of all, as you know, the states are our regulatory partners, and so we're trying to work with them to try to make sure that we accommodate their needs during this time of pause as best we can and really working with them as we come out of this pause.

As you probably are aware, publicly we announced that the pause would go until April 30 and that the last week in April, essentially, there would be an additional announcement at some point to let us know whether the pause had ended or exactly what the Fed would do to kind of start back up doing exam activities. And as Carl said, we don't know for sure how this is going to play out.

But the reason I bring it up today is because at this point, the Fed is really focused on monitoring, doing offsite monitoring work, and all of you have heard from us previously probably a couple of times by now. And those calls, as you know, were meant not to be burdensome but to really just touch base with you and see if there were any pieces of information we could share, any questions we can answer, and so forth and also to kind of gauge how things are going in our local communities.

So that monitoring is going to progress, and I would say that you'll probably be hearing more from us in the next 30 to 45 days. The call should be very similar to what you're used to in the past. As far as exam activities, when we start to come out of this, I would imagine that we'll gradually come out of this and that many exams may be what I would consider more of a streamlined review, and obviously there'll be more to come on that. But suffice it to say we're going to get considerable flexibility, we believe, with respect to mandates.

So having said that, there's a couple things I want to share with you that are kind of ongoing conversations. I talk with many of you almost on a daily basis, it seems like, and I really appreciate that because it gives us good intelligence of what's going on and what you guys are thinking about.

A couple of things I'll share with the group that are worthy of mentioning is we're in this time of uncertainty that conserving capital levels is really an important thing to consider right now that may seem like common sense, but we still from time to time are getting redemption requests and, for that matter, some heavy dividend requests. And I would say at this point in the economic cycle, I would do everything I could do to conserve capital levels at this point. Certainly, putting off any redemptions of any size, and dividends, too, should be really scrutinized, whether we want to pay the dividends now or maybe wait until later in the year.

Along the same lines, I'm hearing a lot that banks are increasing their reserve levels, which is exactly what we would expect banks to do. A number of our banks in the regional bank portfolio and a few of our larger community banks that are publicly traded have had their first quarter after adopting CECL, and they obviously have adjustments that are due to those CECL calculations but also in preparation for what's to come. We really just don't know, and it makes a lot of sense to build those reserve levels. I'm hearing from many of you that's your intention and that's what you've been doing. Do what you can to beef up those qualitative factors and your reserve. I think that should suffice. The main thing is build up those levels, as we don't know for sure was coming down the pike.

Another recommendation—I want to make sure it's clear it's not a requirement, but I think it's a good recommendation to segregate your COVID-19 loans, and these would be the loans that you've modified in some way, maybe there's a deferment. Because clearly you're going to want to track those loans. I've heard from talking to many of you—some have said you've had almost no modifications at all, while others have told us almost 20% of their entire loan portfolio had some level of modification. So, clearly, in these times of uncertainty, you're going to want to track these portfolios separately. It's going to help you make decisions down the road, from a capital planning standpoint, having the knowledge of how big is that portfolio for you and what's to come.

Jim Warren had mentioned in earlier calls, talking about when you do modify these things, do you modify them for 90 days? Do you modify them for six months? Having that information is going to be critical for you going forward, so we recommend that you do that. It's going to help a lot down the road, I think. Plus, it's going to help inform your boards of directors.

And the last thing I would mention is, as you're thinking about your reserves and you're doing your capital planning, I have had several bankers call me to talk about capital planning, and I think it's really important that you segregate those portfolios. So you have your COVID loans, the ones that you've done some modifications to, taking a look at how exposed are you to consumer and residential. Those clearly are going to be hit by the high unemployment rates, and then the last one is your CRE exposures to hotel and hospitality. Some of you on the call have some fairly significant exposures there, while others may not, but those exposures clearly are going to be affected by COVID-19, and you're going to want to closely track those and see how those loans are performing.

So with that, I'll turn it back over to Jim to close out the call for today.

Jim Fuchs:

Great, Allen, thank you very much. And thanks to all of you for joining us. Again, you might have noticed this was a time change. We are committed to the 11:30 a.m. call; we just had—with some of the schedules of folks presenting today, that was unique to today, we needed to make this one-time adjustment. So I appreciate you bearing with us.

As you know, we do record these, and an archive is available on supervisionoutreach.org/conversations, which is basically the Conversations website. So we will be back at 11:30 next week. You heard a number of resources mentioned, and I'm sure some of you were probably furiously writing them down. We have captured all of that. So again, just like we do for every call, in addition to posting the archive, we will also post additional resources. So those great websites that Kathy Paese mentioned. Also, some of the things we mentioned right up front; there's new FAQs out for the PPPLF facility. I'll also share with you that we conducted an Ask the

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Regulators session just yesterday with some of our fellow regulators on the Paycheck Protection Program, where the SBA gave a pretty thorough talk on its process.

You heard from Bill Emmons, and we will certainly put together some of his notes from today and make those available as a resource, but as Carl mentioned, Bill also offers the Take Five program, which usually comes out after every FOMC meeting, and so we are targeting that for either next Friday or that following Monday. So look for that as well.

So again, we will be back at 11:30 next Friday. We appreciate your continued interest in this program. We do appreciate your feedback. Obviously, if this is meeting your needs, we'd like to know that. If it's not, we'd like to know that as well. We want to be a source of information and available to you, and we look forward to speaking with you next week. Thanks, everybody.