Conversations with the St. Louis Fed

May 1, 2020
11:30 a.m. – 12:00 p.m.

Jim Fuchs:

Good morning, everybody, and welcome to the May 1 edition of the Conversations with the St. Louis Fed program. My name is Jim Fuchs, and I appreciate you joining us today. As you know, since the beginning of this pandemic, we have modified the Conversations with the St. Louis Fed program to offer it on a weekly basis every Friday, usually around 11:30 a.m. Central time.

Our goal is really to be responsive to you, state member banks, and others we work with in the Federal Reserve's Eighth District. We have a lot of communication with you throughout the week, and this is an opportunity for us to summarize some of the things we've talked about, share new information on what we've learned, but those conversations are also very important for us to hear from you as well.

So as such, this is a Conversations with the St. Louis Fed program. We encourage your questions throughout the week or even during today's call. You can email them to us at conversations@stls.frb.org. In your invite you saw a link to the Conversations website. I would encourage you to check back on that frequently. We have a number of resources. We have audio from past calls. We have transcripts from past calls. So a lot of good information there.

If you were able to join us last week, you heard from Bill Emmons. He provided an economic update. You also heard from Executive Vice President Kathy Paese in our Treasury division, who was able to provide additional details on the economic impact payments program. For those of you who are interested in learning more about that, not only can you hit last week's archive, but you're also more than welcome to check out the Ask the Fed® website, where we've had a number of sessions in that national call-in forum on that program.

So to kick off today's call, I'm going to turn it over to our Senior Vice President in charge of Supervision, Carl White.

Carl White:

Thanks, Jim, and hello, everyone, again. I'm going to cover just a few things that are pretty timely. So last night, the Paycheck Protection Program Liquidity Facility for non-DIs was announced, and that went live today. One thing I want to point out—and the term sheet's available on the website, if you go to the discount window website, there's all the COVID-related documents and the term sheets there—but the targets are community development financial institutions, members of the farm credit system, small business lending companies, and these are regulated by the SBA, and for the other firms, you can think of fintech firms.

The one difference with this program is, depending on the type of institution, they will be handled by a specific Reserve Bank. So, for example, for the community development financial institutions, if they want to participate in the PPPLF, they would work directly with the Federal Reserve Bank of Cleveland. So while we in St. Louis could certainly assist you with questions, direct you to the right Reserve Bank, we will not be involved with the non-banks. So I refer you to the website, there's links on who to contact, like I said, the term sheet. I'm sure there will be other information available as well. We will also be doing an Ask the Fed® session at some point next week. So be on the lookout for that.

The second announcement that came out late last night was regarding the Main Street Lending Program. We will be actually doing two Ask the Fed® sessions; you only need to attend one. Those will be next week on May 5. We do expect quite a bit of demand for these sessions, so we do ask that you limit to two individuals from your institution to register just so we can manage the capacity. Everything will be recorded and archived. Both presentations will be the same. So, like I said, you only need to sign up for one. The term sheets for the Main Street Lending facility and a very detailed FAQ document is also available, so you can go to the website and look for that as well. You just go to federalreserve.gov and there's a COVID-19 link, which was mentioned in the past, and we'll share all the links when we send out the summary for this call so you can direct yourselves to that.

Like I said, very detailed FAQ document to walk you through the three options within the program. And I say three; you may have remembered initially there was just discussion of two. They added an additional program. So now there's the new loan program and the expanded program, but the new one is called Priority Loan Program, so it's a little different based on risk sharing between the lenders and then also regarding the leverage requirements and how that's calculated.

Terms are somewhat similar, but there are some differences, so I refer you to the term sheets and the FAQ documents, but more importantly, those Ask the Fed® sessions. So the experts will be presenting the details of the programs and will certainly cover as many questions as we can. So please register. You should have gotten that already today if you're already signed up for Ask the Fed®. If not, go to askthefed.org and make sure you're signed up.

So that's the two new developments that came out late last night. I refer you, like I said, to federalreserve.gov, take a look at those term sheets and FAQs. So I'm going to pause, and I'm going to turn it over to Bill Emmons. If you've been on these calls in the past, we've heard Bill speak several times. So we're going to give him a few more minutes today to maybe dive a little deeper into what he's seeing from an economics perspective. So I'll turn it over to Bill.

Bill Emmons:

Thank you, Carl.

I'll mention that we today made available the latest Take Five; that's my summary of what the FOMC did at their meeting that occurred this week and kind of an observation of how that is fitting into the economic picture. There'll be a little overlap, today, what I say with that but largely not. I want to make some additional comments here, and I should say these are my own views, not necessarily of anybody else at the St. Louis Fed.

First, I want to say just a little bit about the pandemic itself. I have not talked about that much in the past, but I've been looking into it, and I feel like a couple points I want to make there. I'll say a little bit about the economy, what the Fed did at the meeting this week, and more broadly, some of the programs Carl and others have been mentioning, talk a little bit about financial and commodity markets, and then sum it up.

So first on the pandemic, on COVID. I think, for the U.S. as a whole, the pandemic is still not under control, and I think that's a message that is very confusing. We're getting so much information. One way to look at this is just to keep track of these curves that you've probably seen, these curves of the cases that have been confirmed and the deaths related to COVID. And there's of course some discussion about maybe we're not counting even the deaths very well, but the source that I'm going to refer to is at Johns Hopkins University and we'll make that site available to you, their Corona Virus Resource Center.

As of yesterday, in the United States, there were over one million confirmed cases and likely many, many more that we don't know about. And that number is up 23% from one week ago. So this is still very rapidly spreading—the numbers of confirmed cases.

Conversations with the St. Louis Fed

May 1, 2020
11:30 a.m. – 12:00 p.m.

The number of identified COVID deaths, as of yesterday in the United States, was 62,996, and that's up 27% from one week ago. And it is said these are low; these estimates, we know, are lower than what is actually happening. But these rates of increase, although slower than a month ago, are still very, very fast.

So, I think that's the basic message—that we're still in the process of trying to flatten these curves, and they are by no means flat at this point. You can also look on this website comparison to other countries, and when you adjust for our population size, the conclusion is that the U.S. cases and deaths are rising faster than in several of our peer countries, including Italy, UK, Spain, France, and Germany. So, the point being, we're at the point where a lot of people already are making preparations to reopen their businesses.

To reopen the economy, it looks like it's going to be partial. It's going to be different in different parts of the country, but I'm just raising the point that the pandemic is still not under control. So it is definitely a high-risk strategy, and I think, as we all know, we need to maintain social distancing. Large gatherings, confined gatherings are still not advisable.

I think there's an issue of how do we handle when there are local outbreaks, that we may not have the protocols and the capacity in place yet. So, the risks from the economic perspective of possibly reopening maybe too soon is that we may have to shut down again. Maybe not nationally but locally. I think there's no question that that could be a pretty severe blow to confidence if that happens—if and when, and certainly for those individuals or vulnerable groups that see that the problem is still there, I think you could see really some withdrawal from economic activity.

I'm not an epidemiologist, but from what I can gather, really the only viable endgame is a safe, effective, widely available vaccine. People are talking about that becoming available in 2021, but we just simply don't know. It could take longer, so it makes me very nervous to be thinking about reopening at this point. I know it can be done without triggering the massive outbreak that we've seen, but it is a high-risk strategy.

So let me then turn more specifically to the economy, and I keep looking, but there's just not much good news to point to. You just can't find any data points that suggest we've found the bottom yet. For example, the unemployment insurance claims numbers that came out yesterday—still in the millions, and we're several weeks now with multimillion claims. We're now over 30 million cumulatively.

Conversations with the St. Louis Fed

May 1, 2020
11:30 a.m. – 12:00 p.m.

The April employment report will come out a week from today, May 8, and the estimates are all over the place. But the unemployment rate is likely to be somewhere in the 10% to 20% range, and it depends critically on how people measure employment. If somebody's furloughed, whether they're counted as employed, whether people have dropped out of the labor force—that's going to matter in how you calculate this number. So it's just going to be a very difficult number to interpret, other than it's going to be bad.

The other major number that comes out—gets a lot of attention—is nonfarm payroll employment, and estimates are that we could see decline of ten million or more, which is just mind boggling in the space of one month. Last month, it was just under a million decline. The first quarter real GDP report did come out this week and showed a decline of just about a 5% annualized rate. Everybody is expecting the second quarter to be much, much worse and, hopefully, the worst in the whole episode. People are speculating it could be at a 20% to 30% annualized rate of decline and then possibly start to see some positive numbers in the second half of this year.

I've mentioned before the New York Fed puts together as close to a real-time indicator as you could probably get, combining daily and weekly information. Their latest reading suggests that real GDP right now is about 12% below what it was a year ago. You'd have to go back to 1946 to find a full-year decline as severe as 12%. That was after World War II demobilization; prior to that, the Great Depression. The consensus numbers that I've seen for the year as a whole, which is taking into account some bounce back in the second half, is more like a 6% decline for the whole year, and that would be more than double the worst 2009 number.

So it's just really hard to find good news in the economy right now. The Fed met this week, kept the Fed funds target rate range at 0% to 0.25%. The interest on excess reserves maintained at 10 basis points. The asset purchases in the first six weeks of this crisis, where we went back to the quantitative easing strategy, have now accumulated to $1.6 trillion—an amazing rapid rollout of that program, and our total Fed balance sheet has increased even more, over $2 trillion. Some really, really dramatic moves there.

The Fed has said—FOMC leaders have said that they do not anticipate pushing the short-term rate into negative territory. However, there are some indications in financial markets that investors think that that is possible—shouldn't rule that out completely. And that's also consistent with what former Chair Ben Bernanke said a few weeks ago, that he thought it was wise to keep that option on the table, so I think that is something that bankers need to be thinking about. It's not impossible that the short rate could go negative.

The financial market interventions the Fed's undertaken have been also unprecedented. Incredible. There are 12 separate programs. Emergency Fed funding, credit, liquidity, and loan facilities, several of which have been discussed on these calls and in Ask the Fed® sessions. If you're interested, you can find a listing of all of those and their details. So just extraordinary times; each week reinforces that point.

Maybe turning a little bit to financial and commodity markets, I've been saying for some time, and I think it's still true, that the financial markets are showing more progress or more stability than the economy. One way to think about it is look at the stock market. It's really quite surprising that, given the scale of this economic downturn we're talking about, that the stock market's not down even more than it is. In fact, on a year-over-year basis, it's barely down at all. So I think that's in part indicative of the idea that this could be a shorter—not a drawn-out recession but could be fairly short, and that recovery, when it begins, could be pretty rapid, but again, that's still an uncertain situation.

The stock market volatility, the VIX index, which I've pointed to in the past, is still about twice its normal level. But, on the other hand, it's only half its worst point, which occurred in mid-March. So some notable progress there. You can also look at things like credit spreads, lower rated bonds versus higher rated or Treasuries. Those spreads are higher than they were before March, but they have come down and they have stabilized, so it looks like credit markets are functioning again in a pretty reasonable way.

The very, very low level of long-term interest rates still makes me think investors are looking for slow growth over the medium term. Ag prices are mixed. Energy—we have this bizarre negative price on oil last week. It's, of course, bounced back into positive territory, but oil prices are still very, very low. It makes me think that most domestic shale production capacity is probably not viable at these levels$20 in west Texas.

So summing it up, the economic news is bad; there's just no way to spin that. Financial markets give you a little bit of optimism. And I think the fact that the Fed has been very aggressive, very creative, actually has made a big difference, probably more on the financial side than on the economic side at this point, given that interest rates were already so very low even before the crisis. So hopefully we'll see some recovery in the second half of the year, but a lot of uncertainty we have to get through before then. I'll leave it at that.

Carl White:

Great. Thanks, Bill. Okay, we're going to turn it over to Doug Kerr. Doug's an officer in our Consumer Compliance area. He's going to cover some considerations that have come up from a compliance perspective regarding the pandemic. Turn it over to you, Doug.

Doug Kerr:

Thanks, Carl, and hello, everyone. So as you all are probably aware we have been in exam pause for the last month or so, and at this time we do encourage banks to continually work with their customers and provide relief, where possible, through deferments, things of that nature, reduction fees, those sorts of things. I guess what I would say is that our supervisory approach coming out of this, we will try to do the same for you, give relief where possible.

So there was an interagency statement on loan modifications released on April 7, and that kind of detailed what I'll say here in a second, which is we are getting mindful of the challenges that you all are facing during this time, and our approach will focus on supervisory feedback as opposed to enforcement-action-type work. We want to make sure that good faith efforts are made working with these customers. But again, we don't want to beat you over the head for working with customers if you don't dot every I and cross every T.

There have been some other relaxations and currentsregulations and I wanted to detail that as well.

There was an interagency statement that was given on April 3 around mortgage servicing, and what that kind of talks about is some delays and escrow analyses and the ability to do that, as well as some other disclosure requirements that will not be necessary with regard to deferments and forbearances when working with customers in this avenue. So again, summary of that is we want to work with you guys, we want to make sure that we're helping you serve your customers and making sure that the way that we supervise after this is appropriate.

The next thing I want to kind of touch on are a couple of items that have come up with regard to the PPP program and some fair lending concerns that may have arisen. The first of these is the practice of lending only to current customers. So typically this would elevate—fair lending risk and might something we might be concerned about, but we are aware that in this situation, the speed and the delivery of funds is very, very crucial. And if you're not able to get these loans approved quickly, you may not get the funds at all. We also are aware of the current BSA requirements; we know your customer requirements could slow down that process for noncustomers, and so we understand that there might be decisions to be made, business decisions around who you lend to. All we ask in this scenario is that you document those decisions, and if you have a policy around them and apply it consistently across your customer base.

Another thing that has come up is the idea of prioritizing loan amounts. In other words, larger loan amounts might be approved first, resulting in lower loan amounts not getting approved at all. Typically, again, this would elevate risk, and we would have concern there, but we do understand at this time that the speed of delivery and the availability of funds might require prioritization of loans. Similarly, we would say here, document business decisions that you made and make sure that you apply it across your portfolio as opposed to inconsistently.

The last thing that I did want to touch on was a release that happened last week, last Friday, with regard to Regulation D. So as of March 26, reserve requirement ratios were reduced to 0%, which eliminated the requirement for reserves. As a result, the distinction between the reservable transaction accounts and non-reservable savings deposit accounts is no longer a necessary item. Due to this, the six-transfer limit has been eliminated. There's no need to monitor that or enforce that, no issue there. But this is optional. Banks are still allowed to enforce a six-transfer limit, so again, it's not required but something you still can do. If you have policies and procedures in place by which you charge fees to go over those limits, you certainly still can do that as well. I will say, if you do eliminate the six-transfer limit, it can be reported as either a transaction account or continue to be reported as a savings, again no requirements there. But, again, from the Reserve Bank and the System perspective, there is no requirement to do that one way or the other.

So I think those are the three items that I wanted to cover. And with that, I will turn it back to Carl.

Carl White:

Thanks, Doug. Okay, last speaker today. We're going to turn it over to Scott Smith. Scott is an officer in our Safety and Soundness area, so I'm going to turn it over to Scott.

Conversations with the St. Louis Fed

May 1, 2020

11:30 a.m. – 12:00 p.m.

Scott Smith:

Good morning. I'm going to start by mentioning—my topic is capital resilience, and I'm going to get to that very quickly but I'll start to get there by talking about how we've een having conversations with our community banks over the last six weeks about the crisis and all the impacts that have been happening on the banks, and over the last couple of weeks we extended that and talked to a much wider range of banks—rural, suburban, urban, different business models—hearing about the challenges they're experiencing: staffing, operational credit, liquidity, earnings, the full range of everything.

And the key topic that keeps coming up is uncertainty. In the current environment, as Bill Emmons was saying, we don't know how long it's going to last. We don't know how severe it's going to be. The impact is everywhere, but it varies in severity geographically and by business models, so there's a lot of uncertainty. We're interested in how banks and holding companies prepare for that and deal with that.

And as in every downturn, a key topic is going to be capital, because capital is a key element in the resilience of organizations and being able to manage through tough times. The industry as a whole is in a much better position regarding capital in 2020 than it was before the start of the last downturn. But there is that element of the unknown, the uncertainty. And many banking organizations have already paused stock buybacks and are reconsidering dividend plans. And we're a bank regulator, and so we kind of like that, we especially like that they're thinking about it, that they're taking a thoughtful approach to it in assessing their risk and the future risks that are out there.

Because we're a bank regulator, there's guidance out there, and I wanted to share that with you today. It's Supervision and Regulation letter 09-4. The 09 means that it came out in 2009, and it's got a mouthful of a title, *Applying Supervisory Guidance and Regulations on the Payments of Dividends, Stock Redemptions, and Stock Repurchases of Bank Holding Companies,* and we'll have a link available to get you to that if you don't have it already.

It even says in there it reiterates longstanding policies and guidance on this. So it's one-stop shopping on the Federal Reserve's position on this, and the SR letter is basically common sense. It's written directed at bank holding companies, but it is great guidance for banks as well. It talks about very specifically—the holding company needs to serve as a source of managerial and financial strength to its subsidiary banks, and the guidance specifically directs firms to consider reducing, deferring, or eliminating dividends when the quantity and quality of earnings have declined or the BHC experiences other financial problems or the macroeconomic outlook is deteriorated. Obviously, we're dealing with that. At one point it's got nine bullets in there, things to consider when you're putting your dividend practices and policies and plans together—asset quality concentrations, declines in asset values, risk to earnings, the ability to raise additional equity capital. All those things are in play to some extent for every bank right now and should be part of the dividend planning process.

So it does have some guidance in there asking you to inform or consult with Federal Reserve supervisory staff in advance of declaring or paying dividends that could raise safety and soundness concerns—say it exceeds earnings for the period, and there's a lot of detail on that. You can go and take a look at it. Again, we want to be involved as necessary but not be too burdensome in this process. But I think it's important in this time that kind of reemphasize the importance of capital and conserving it if necessary.

Just to kind of wrap up: We're in this difficult period of uncertainty. Get in touch with your supervision contact, any of the officers or your supervisor, your portfolio examiner. If you've got any questions, we'll be glad to talk to you about that. And we're going to continue those conversations that we've been having with bankers over the last few weeks.

If we haven't called you yet—we're trying to change it up and talk to some different banks each week—and you've got something, we would love to hear from you. Feel free to call me or call anybody else on our supervision staff, and we'd be glad to talk. That's it; I'll turn it back over to Jim Fuchs.

Jim Fuchs:

Great, Scott. Thank you very much. Thanks to Doug Kerr, Bill Emmons, and of course, thanks to Carl White, and thanks to all of you for joining us today. To wrap up, I wanted to remind everybody that this Conversations program is being recorded, and an archive of the recording will be available on the Conversations website, as all our programs are recorded. We'll also have a transcript up in a couple days as well, so that you can reference that. A lot of good information came out today. Hopefully you find that beneficial.

We have added those resources on the Conversations website, so a number of those programs that Carl referenced. We usually do a summary of what Bill discusses, and also Bill talked about the Take Five program. Scott referenced SR letters. There's a lot out there; I encourage you to come back and check that out.

Also posted, you'll see some minutes from a national meeting of the Community Depository Institutions Advisory Council. Each Reserve Bank has a council, and I know a number of our members are on this call. The April 2 meeting specifically discussed what banks nationally were doing to combat the COVID-19 pandemic. I thought some of the information there might be interesting to our members.

With that, I also want encourage you throughout the week to continue sending us your questions: conversations@stls.frb.org. This is a program for you. So again, as Scott mentioned, you're going to be hearing from us; you're going to be talking to examiners; you're going to be talking to our leadership. And you can certainly suggest questions during those calls. Please, throughout the week: conversations@stls.frb.org Great way to get your question heard, a great way for us to build that into our future programming. So we will talk to you next week. Thank you for joining us today.