KEY TAKEAWAYS – 2021 UNC BANKING INSTITUTE IN CHARLOTTE

Assessing the Effects of the Pandemic on Bank Health

The COVID-19 pandemic presented the U.S banking system with its greatest systemic challenge since the Global Financial Crisis. With the end of the pandemic in view, banking industry leaders and regulators gathered at the Banking Institute of the University of North Carolina School of Law's Center for Banking and Finance to assess how banks have weathered the storm—and what the post-pandemic future may hold. Highlights of the discussion included the following:

BANKS HAVE HELD UP WELL TO THE COVID-19 STRESS TEST

Capital and liquidity positions are stronger now than they were before the pandemic. While this contradicts the post-2008 playbook, which calls for capital to drop as banks loan it out during times of upheaval, the heightened demand for loans simply didn't materialize, as companies instead turned to $700 billion in credit line drawdowns and a record year for corporate issuance to access capital. Banks earned kudos as well for their steady management of operational risk during the pivot to a work-from-home environment—although difficulties emerged in the internal control function.

BUSINESS CONDITIONS REMAIN AS CHALLENGING AS EVER

Banks have reason to celebrate their pandemic performance, but they can't rest on their laurels. Bank franchise values are severely depressed. Regulatory costs continue to increase while earnings pressure continues, with the compression in interest margin at historic lows (recent developments notwithstanding). Bank stocks continue to underperform relative to the market; to make matters worse, with investors regarding banks like utilities, banks are now effectively locked in to paying dividends. Competition from fintechs continues to accelerate, with the payments space emerging as the new battlefield.

LOOKING AHEAD, UNCERTAINTY LOOMS

The pandemic's effects on asset quality has been less than expected—so far. But what happens once forbearance and government stimulus come to an end? Diminished asset quality is all but certain—the question is, will the effects be enough to impact balance sheets, or will banks be able to control the damage? Who wins and who loses will be determined by loan mix and regional and industry concentration.

THE PANDEMIC SHONE A BRIGHT LIGHT ON COMMUNITY BANKS

There's a heightened appreciation of the role that community banks play as "the lifeline to Main Street," and a resulting awareness of the role regulators can play in helping these institutions thrive. The Federal Reserve Board is thus examining community banks' supervisory risk while other agencies are establishing "office hours" so that community banks can ask questions in a non-supervisory setting regarding the fintech partnerships that many are embracing.

THE PANDEMIC ISN'T EVERYTHING

As much as it has dominated banks' energy, the pandemic has not eliminated other items from the strategic agenda:

KNOW THE COMPANY YOU KEEP As more banks partner with fintechs—or with technology providers into order to compete with fintechs—it becomes increasingly important for banks to have effective governance in place to manage the reputational risk these partnerships bring. With an interagency group devoted to third-party risk, additional (and welcomed) guidance is likely forthcoming.

A DRIVE FOR EQUALITY AND INCLUSION ON BOTH SIDES OF THE BANKER'S DESK There is a healthy competition between banks regarding DE&I recruiting, onboarding and retention. Simultaneously, there is a heightened focus on increasing investment in diverse communities and expanding access through products to help "bank the unbanked." And while regulatory agencies don't incorporate DE&I benchmarks in their supervisory role, agencies are making efforts to increase the diversity of their staff.

IMPENDING STANDARDS CHANGES Over the next two years, banks must grapple with the implementation of both the current expected credit loss (CECL) accounting method and the retirement of the LIBOR benchmark. While preparations for both are underway, implementing these transitions will consume increasing resource share as deadlines approach.

CLIMATE RISK ENTERS THE EQUATION The Federal Reserve's establishment of a climate risk committee represents a recognition that climate change is now a concrete decision-making component. Going forward, banks will be working to integrate this risk in due diligence and risk management.

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ABOUT THE PANEL

Our thanks to the members of the panel, "Long-Term Effects of COVID-19 on Bank Health": **Greg Baer,** Bank Policy Institute, New York; **Katie Bosken,** Office of the North Carolina Commissioner of Banks, Raleigh; **Greg Coleman,** Office of the Comptroller of the Currency, Washington, D.C.; **Ed O'Keefe,** Moore & Van Allen, Charlotte (coordinator); and **Lisa White,** Federal Reserve Bank of Richmond, Richmond.

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