Loan Payment Relief Due to COVID-19: Audit and Risk Considerations

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With You Today

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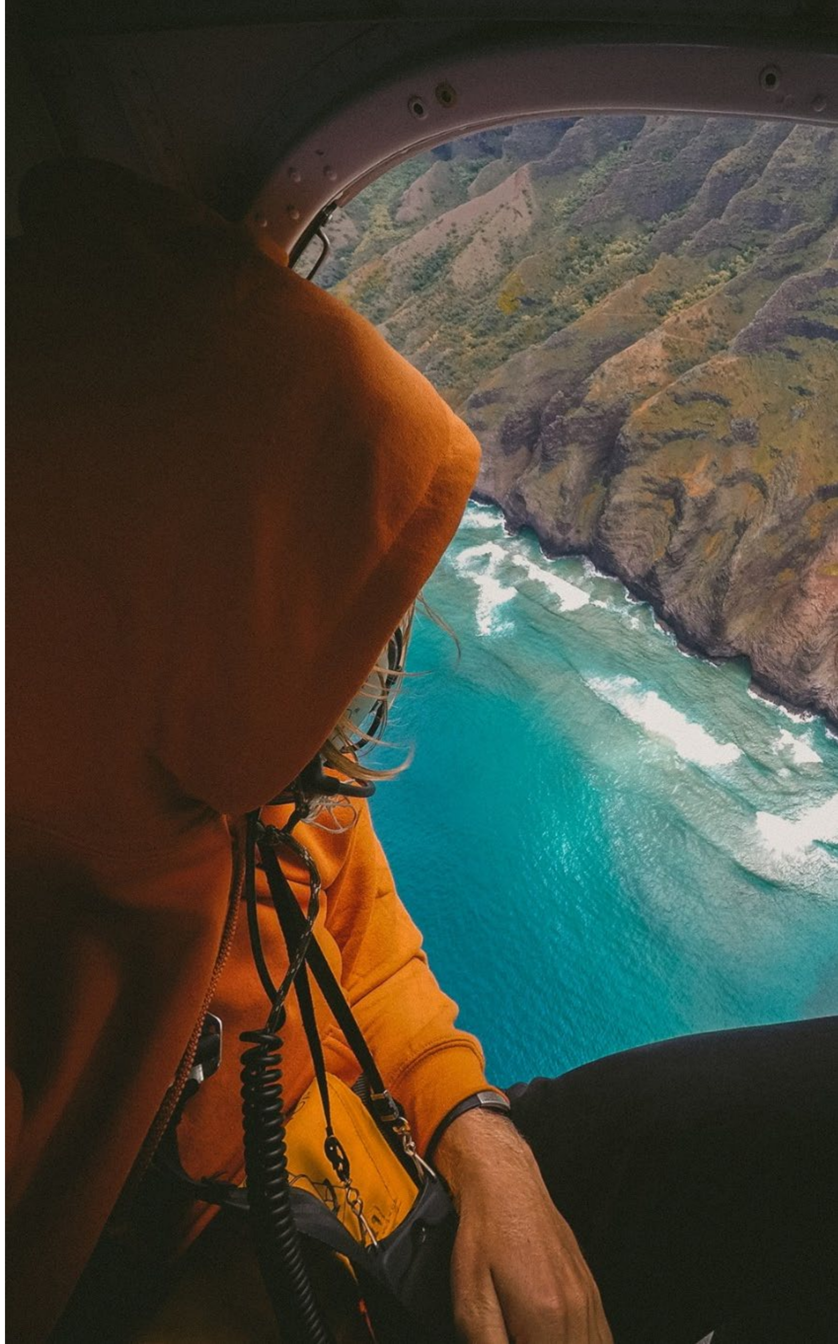
Goals For Today:

- Understand CARES Act vs. Interagency Guidance
- Industry Trends – Loans and Credit Loss
- Allowance and Financial Reporting Considerations
- Audit considerations



Loan Modifications

Loan Modifications – Interagency Guidance

- Issued March 22, 2020, prior to the signing of the CARES act, in response to the COVID-19 pandemic
- FASB issued a statement of agreement with the interagency guidance
- Encourages working with borrowers to modify loans
- Includes detailed examples of modifications along with regulatory expectations
- Guidance refers to modifications of up to 6 months potentially not being considered troubled debt restructurings (TDRs) if pandemic related
- Delinquency reporting eased in this area
- https://mossadams.com/articles/2020/03/financial-institution-guidance-covid-19

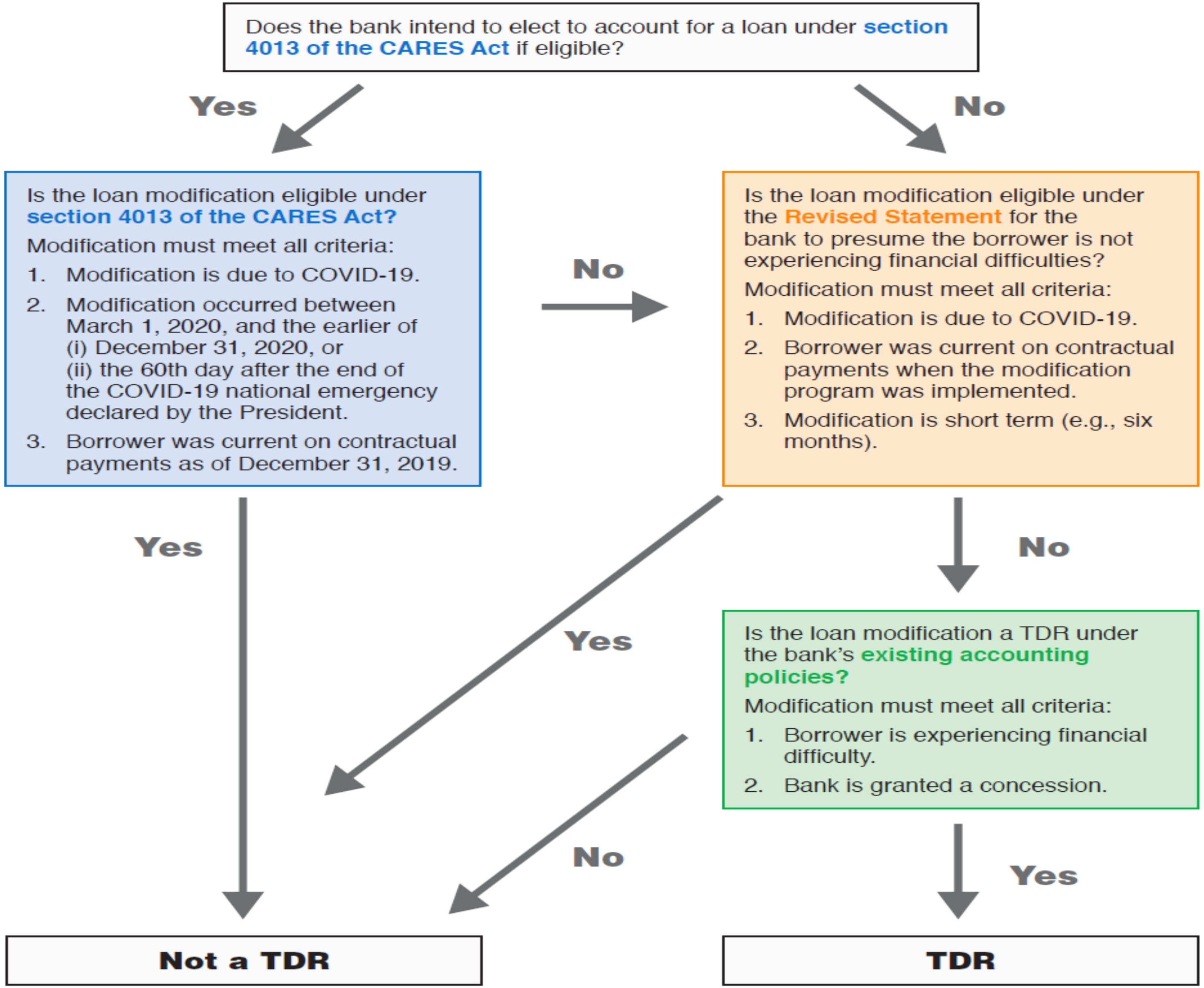
Loan Modifications – CARES Act

- Option to suspend requirements under US GAAP for loan modifications related to the pandemic that potentially would have otherwise been considered troubled debt restructurings.
- Must be current at December 31, 2019 (under 30 days past due) and the modification performed due to the pandemic to qualify.
- Includes modifications such as forbearance agreements, interest-rate modifications, repayment plans, or other arrangements that defer principal and interest payments.
- Election may begin on March 1, 2020 and last no later than the earlier of December 31, 2020 or 60 days after lifting of the coronavirus national health emergency.
- https://mossadams.com/articles/2020/03/cares-act-includes-cecl-and-tdr-relief

	Section 4013 of the CARES Act	Non-Section 4013 Loan Modifications (Revised Statement)
Evaluation date of whether borrower was current (< 30 days past due)	December 31, 2019	No earlier than when the modification program is implemented
Modifications terms allowed (safety and soundness principles still apply)	Any modification	Short term (e.g., six months)
Time period of when the modification occurs	Between March 1, 2020, and the earlier of (i) December 31, 2020, or (ii) the 60th day after the end of the COVID-19 national emergency declared by the President.	Management should use judgment to determine if the modification is related to COVID-19.
Duration of non-TDR designation	Remaining life of the loan. Subsequent modifications must be evaluated if they are not also eligible under the criteria.	Remaining life of the loan. Subsequent modifications must be re-evaluated.
Why is it not a TDR?	By law, the bank is not required to designate the loan as a TDR.	The bank may presume that the borrower is not experiencing financial difficulty.

If neither section 4013 of the CARES Act nor the Revised Statement criteria are met, the bank should follow its existing accounting policies to determine whether the modification should be accounted for as a TDR.

Is the COVID-19 Loan Modification a TDR?



Modification Considerations

- What are the controls in place to ensure proper documentation and classification of the modifications under policy, Interagency guidance or CARES ACT?
- What are the flagging/tracking mechanisms in place? Are they automatic or manual given multiple loan systems in play?
- Will regulators be critical if modifications are outside the six month deferral period as mentioned in the Interagency guidance?
- What documentation will be required to prove modifications are pandemic related?
- How will the Credit Union prepare for processing additional modifications?
- How should we be treating interest recognition (accrue or not) given varying modification programs?
- Loan Payment Deferral Accounting Considerations During COVID-19

Polling Question 1

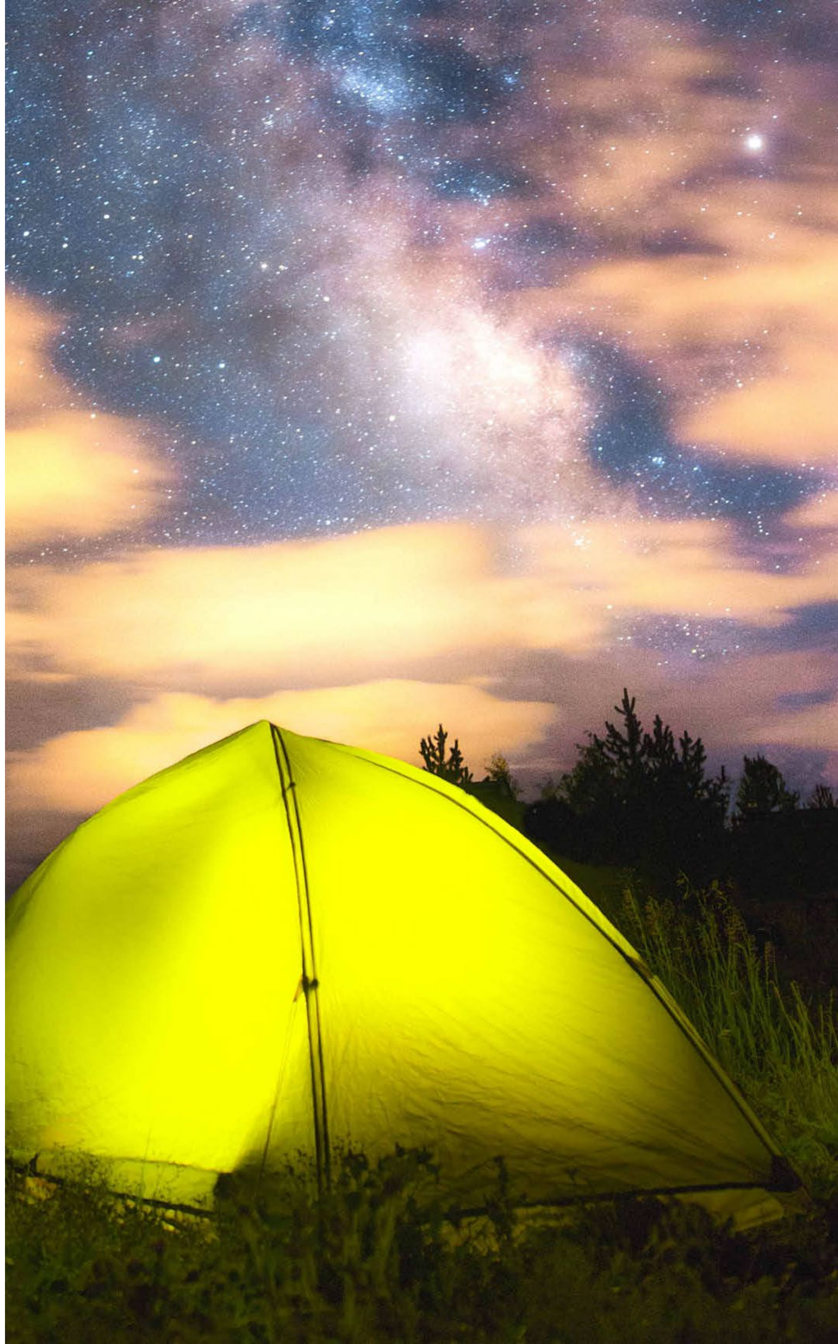
What Percentage of Loans Have Been Modified or Deferred Due to COVID-19

A) less than 1%

B) 1 - 5%

C) greater than 5%

D) Unsure

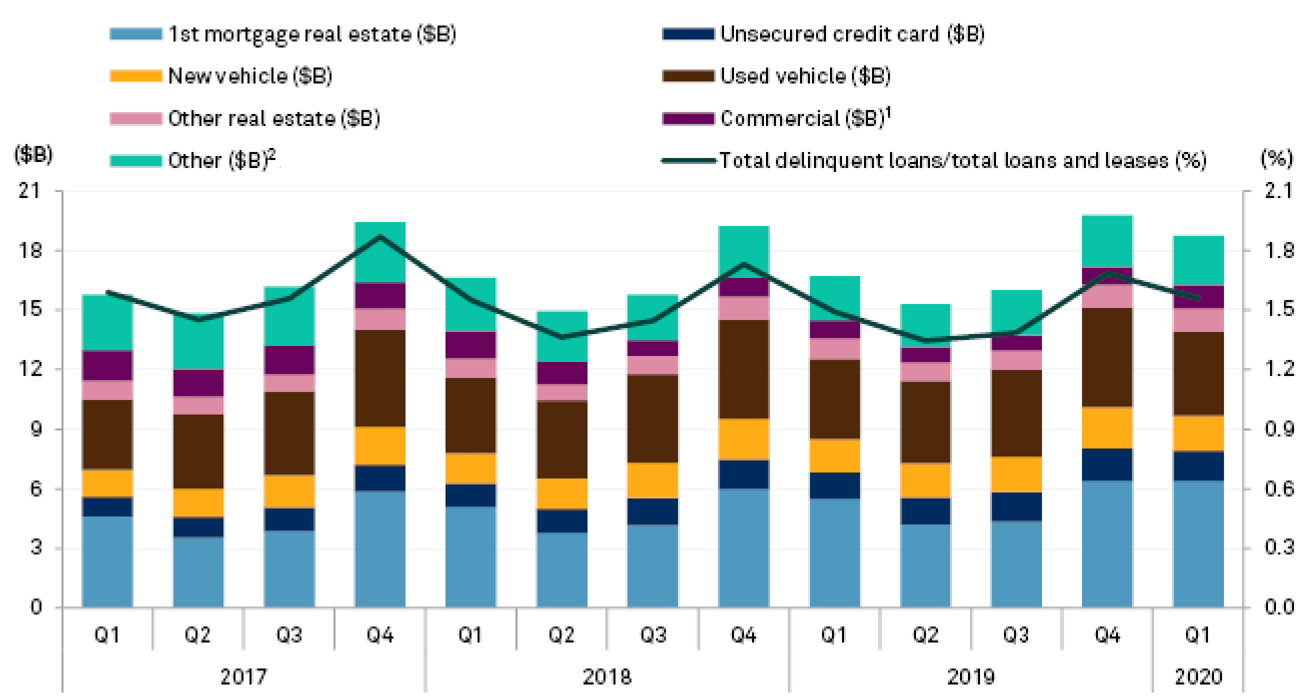


Industry Trends

Charge-Offs and Delinquencies Slightly Increasing

- ✓ Compared to March 31, 2019, over 30 day delinquencies have increased 7 basis points to 1.56%
- ✓ Delinquencies are being somewhat masked due to modification efforts and CARES Act relief efforts
- ✓ With some modifications expiring, Q2 & Q3 will be interesting!

Delinquencies at US credit unions, by loan type



Data compiled June 24, 2020.
Analysis based on regulatory filings for all U.S. credit unions as of March 31, 2020.
Delinquencies include loans 30 days or more past due.
[1] Includes member and nonmember commercial loans secured and unsecured by real estate.
[2] Includes payday alternative loans, non-federally guaranteed student loans, lease receivables and all other loans reported by credit unions.
Source: S&P Global Market Intelligence

Expected Surge in Loan Losses

- ✓ Losses are expected to surge in Q2 and beyond for many large commercial banks
- ✓ Initial relief periods should be expiring on many loans, and expectation is there will be additional extensions/modifications for many.
- ✓ Continued business failures projected to continue due to COVID-19 impact.

Analysts expect charge-offs to pick up in Q2'20, then surge and remain elevated into 2021

			Net charge-offs/average loans (%)					
			Actual		Estimate[1]			
Company (ticker)	City, state	Q1'20 total assets ($B)	Q4'19	Q1'20	Q2'20	Q3'20	Q4'20	Q1'21
JPMorgan Chase & Co. (JPM)	New York, NY	3,139.43	0.63	0.61	1.04	1.45	1.97	1.83
Bank of America Corp. (BAC)	Charlotte, NC	2,619.95	0.39	0.44	0.64	1.03	1.38	1.20
Citigroup Inc. (C)	New York, NY	2,219.77	1.11	1.17	1.48	2.08	2.73	2.84
Wells Fargo & Co. (WFC)	San Francisco, CA	1,981.35	0.31	0.37	0.47	0.87	1.24	1.35
U.S. Bancorp (USB)	Minneapolis, MN	542.91	0.51	0.52	0.67	1.00	1.46	1.58
Truist Financial Corp. (TFC)	Charlotte, NC	506.23	0.40	0.35	0.51	0.80	0.99	1.01
PNC Financial Services Group Inc. (PNC)	Pittsburgh, PA	445.49	0.35	0.35	0.47	0.72	1.06	1.28
Fifth Third Bancorp (FITB)	Cincinnati, OH	185.39	0.41	0.44	0.58	0.89	1.30	1.50
Citizens Financial Group Inc. (CFG)	Providence, RI	176.72	0.40	0.44	0.53	0.82	1.11	1.08
KeyCorp (KEY)	Cleveland, OH	156.20	0.42	0.34	0.53	0.84	1.21	1.11
Regions Financial Corp. (RF)	Birmingham, AL	133.54	0.46	0.59	0.71	0.95	1.15	1.07
First Republic Bank (FRC)	San Francisco, CA	123.91	0.00	0.00	0.05	0.09	0.13	0.16
Huntington Bancshares Inc. (HBAN)	Columbus, OH	113.90	0.38	0.61	0.58	0.75	0.99	1.10
Comerica Inc. (CMA)	Dallas, TX	76.34	0.16	0.65	0.63	0.76	0.94	1.09
SVB Financial Group (SIVB)	Santa Clara, CA	75.01	0.18	0.35	0.42	0.56	0.76	0.61
Zions Bancorp NA (ZION)	Salt Lake City, UT	71.47	0.18	0.06	0.28	0.51	0.76	0.82
People's United Financial Inc. (PBCT)	Bridgeport, CT	60.43	0.06	0.10	0.17	0.34	0.53	0.61
New York Community Bancorp Inc. (NYCB)	Westbury, NY	54.26	0.03	0.10	0.11	0.16	0.25	0.25
Synovus Financial Corp. (SNV)	Columbus, GA	50.62	0.10	0.21	0.39	0.60	0.82	0.72
Median, more than $50B in assets			**0.38**	**0.37**	**0.53**	**0.80**	**1.06**	**1.09**
Median, $5B-$50B in assets[2]			**0.13**	**0.12**	**0.24**	**0.37**	**0.55**	**0.66**

Data compiled July 3, 2020.
Data reflects public U.S. banks with more than $50 billion in total assets as of the fiscal first quarter of 2020, and with three or more estimates for both net charge-offs-to-average loans and loan loss provisions for the fiscal first quarter of 2021.
Data based on GAAP filings.
[1] Represents the consensus mean estimate for net charge-offs-to-average loans collected by S&P Global Market Intelligence.
[2] Data reflects public U.S. banks with total assets between $5 billion and $50 billion as of the fiscal first quarter of 2020, and with three or more estimates for both net charge-offs-to-average loans and loan loss provisions for the fiscal first quarter of 2021.
Source: S&P Global Market Intelligence

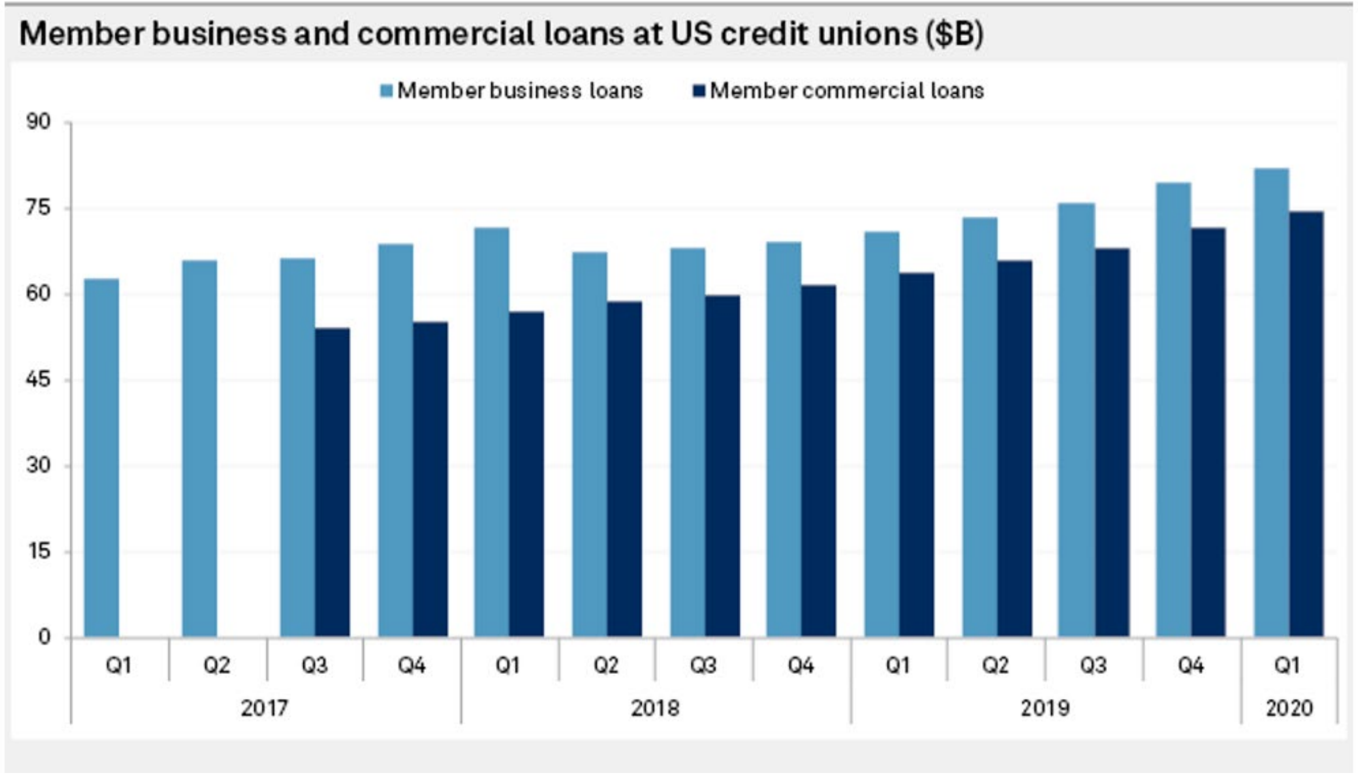
Expected Surge in Loan Losses

Forecasts anticipate the heaviest provisions in the first half of 2020

			Provision for loan losses ($M)					
			Actual		Estimate[1]			
Company (ticker)	City, state	Q1'20 total assets ($B)	Q4'19	Q1'20	Q2'20	Q3'20	Q4'20	Q1'21
JPMorgan Chase & Co. (JPM)	New York, NY	3,139.43	1,401.0	8,285.0	7,929.0	5,991.3	4,762.0	4,388.8
Bank of America Corp. (BAC)	Charlotte, NC	2,619.95	937.0	4,761.0	5,431.3	4,006.2	3,009.6	2,906.8
Citigroup Inc. (C)	New York, NY	2,219.77	2,123.0	7,027.0	7,169.0	5,951.8	4,250.5	4,851.5
Wells Fargo & Co. (WFC)	San Francisco, CA	1,981.35	644.0	4,005.0	4,843.3	3,432.5	2,756.9	2,868.4
U.S. Bancorp (USB)	Minneapolis, MN	542.91	395.0	993.0	1,538.2	1,147.5	932.7	1,087.1
Truist Financial Corp. (TFC)	Charlotte, NC	506.23	168.0	893.0	1,228.6	887.1	627.9	606.5
PNC Financial Services Group Inc. (PNC)	Pittsburgh, PA	445.49	221.0	914.0	1,219.7	799.0	683.5	726.8
Fifth Third Bancorp (FITB)	Cincinnati, OH	185.39	172.0	625.0	606.1	426.9	318.1	351.3
Citizens Financial Group Inc. (CFG)	Providence, RI	176.72	110.0	600.0	666.4	477.8	357.5	355.7
KeyCorp (KEY)	Cleveland, OH	156.20	106.0	359.0	584.9	375.3	268.1	263.7
Regions Financial Corp. (RF)	Birmingham, AL	133.54	96.0	373.0	514.2	304.2	272.5	228.9
First Republic Bank (FRC)	San Francisco, CA	123.91	9.6	62.4	71.7	56.2	39.1	52.5
Huntington Bancshares Inc. (HBAN)	Columbus, OH	113.90	74.0	441.0	379.1	266.9	197.0	193.2
Comerica Inc. (CMA)	Dallas, TX	76.34	6.0	411.0	230.7	163.2	116.1	127.1
SVB Financial Group (SIVB)	Santa Clara, CA	75.01	13.2	243.5	118.3	81.9	65.0	80.3
Zions Bancorp NA (ZION)	Salt Lake City, UT	71.47	7.0	258.0	195.2	130.5	100.7	94.7
People's United Financial Inc. (PBCT)	Bridgeport, CT	60.43	7.3	33.5	89.1	78.0	55.0	57.5
New York Community Bancorp Inc. (NYCB)	Westbury, NY	54.26	1.7	20.6	32.8	33.3	24.8	23.9
Synovus Financial Corp. (SNV)	Columbus, GA	50.62	24.5	158.7	148.6	103.0	76.2	71.5
Aggregate, more than $50B in assets			6,516.3	30,463.7	32,996.0	24,712.5	18,913.1	19,335.9
Aggregate, $5B-$50B in assets[2]			236.7	2,265.2	1,821.9	1,386.3	1,163.0	1,065.0

Business Lending Growth

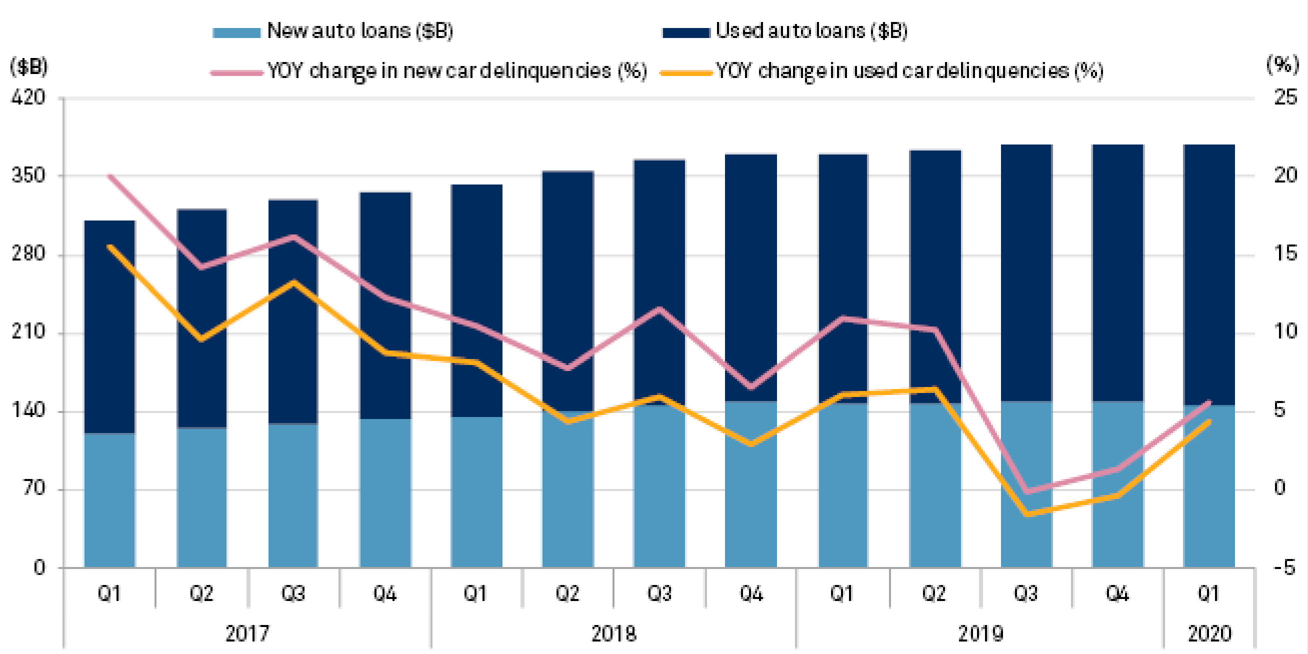
- ✓ Business loans have increased 16% year over year
- ✓ Industry has over $82 billion outstanding
- ✓ PPP loans are a contributor



Auto Loans Finally Decline

- ✓ Auto loans grew only 2% year over year to $380 billion
- ✓ First quarter over quarter decline in 9 years
- ✓ The COVID-19 impact to the economy, and businesses (such as dealers), contributed to the decline

Auto loan trend at US credit unions



Data compiled June 23, 2020.
Analysis based on regulatory filings by U.S. credit unions.
Delinquencies include past-due and nonaccrual loans.
Source: S&P Global Market Intelligence

Allowance and Financial Reporting Considerations

Allowance and Financial Reporting Considerations

- How are we comprehensively analyzing members with multiple loans?
  - Grading considerations in general and by industry (higher risk industries)
  - What about members that are attached to these businesses?
  - Did they receive PPP loans?

- How are we analyzing unfunded commitments and potential increased utilization by product?

- Are we monitoring credit reports, and are we just focused on FICO? Or are we paying attention to other trends identified?

- How are we building upon qualitative factors within the allowance estimate within each major segment, breaking down by concentrations of employment? Industry?

- How can delinquency masking occur, how can we monitor this?

Allowance and Financial Reporting Considerations

- Financial reporting risk – Liquidity is high, margins are thin, fee income is low, there could be pressure for manipulation in general. Increased risk attention.

- Financial reporting risk – knowing re-defaults will occur, have we ensured modification protocols and reporting stay intact?

- Call reporting – How is management ensuring accurate preparation of the 5300 Call Report?
  - Modified loans
  - Delinquencies
  - Changes on the horizon

Additional Audit Considerations

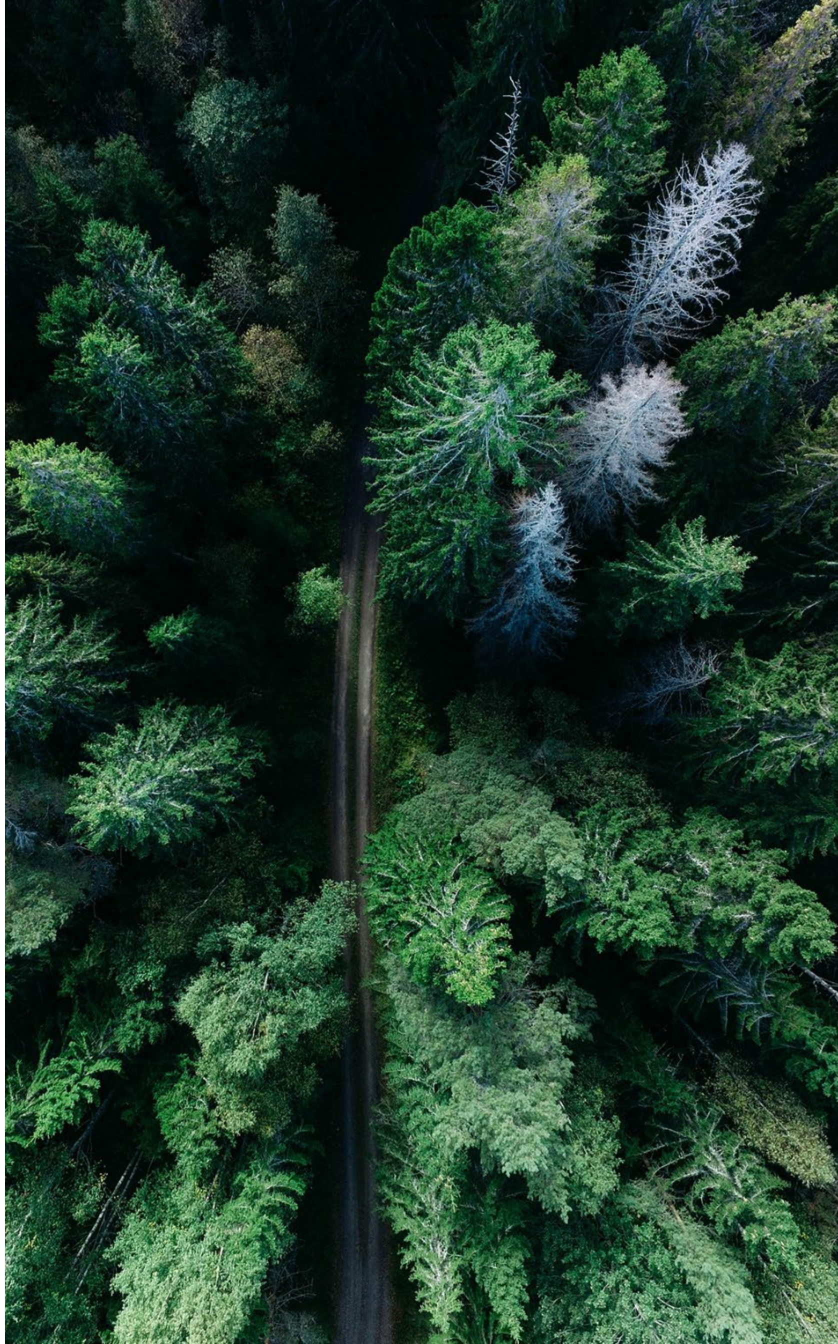
Polling Question 2

Has Your Audit Plan or Risk Assessment Been Updated Since the COVID-19 Impact?

A) Yes

B) No, but on the agenda

C) No and no plans to update



Additional Audit Considerations

- Has the Supervisory/Audit Committee discussed the control environment related to pandemic modifications?

- Audit programs should be updated based on assessed level of risk. For instance:
  - Increase focus on file maintenance controls
  - Targeted testing of modifications
  - Testing accuracy of reports
  - Use of non-lending employees to process loans
  - Post-boarding quality control reviews

- What other areas of the Credit Union may be suffering due to increased focus on collections?

- Balance sheet – have assumptions been updated within financial modeling?

- How rigorously will IT controls be tested:
  - Have IT controls related to system updates been implemented?
  - Have user access controls been monitored?
  - Any compromises to IT systems?

Polling Question 3

Do You Expect to Complete Your Audit Plan During 2020?

A) Yes

B) Yes, but we are outsourcing more audits

C) No, we will reduce audits completed

Navigating Through Challenging Times

We are in unprecedented times which will change daily, and financial institutions need to keep up to speed on various accounting, tax, regulatory and economic changes.

We maintain an active COVID-19 dedicated website:

https://www.mossadams.com/covid-19-implications

We also encourage you to sign up to receive our insights and alerts:

https://mossadams.com/insights