FORTRESS PARTNERS
E-Memo

TO: INVESTORS/MEMBERS, BANKERS AND
FROM: Ed Depenbrok & Jon Bruss
DATE: April 30, 2020
SUBJECT: Banking on Acronyms

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In February we asked you *Can Community Banks Grow Organic Deposits and Loans AND Increase Earnings?* We'd answer that question today just as we did two months ago.

But, we'd add to that discussion our topic for April, *Banking on Acronyms.* The world was changing back in February but those changes were not really on our community banking radar screen. The acronyms we have in mind have the potential to change nature of community banking and, for that matter, the entire commercial banking industry.

Current Expected Credit Loss The first acronym is **CECL** (pronounced as you'd pronounce the surname Cecil) also known as the Current Expected Credit Loss methodology.

CECL was created by the same folks **FASB** (acronym #2), the Financial Accounting Standards Board, which brought us the mark-to-market accounting standard imposed on the banking industry. According to many economists and banking expertss, mark-to-market led to the near-collapse of the global economy in the midst of the Financial Crisis of 2008. **CECL** is another form of the mark-to-market standard, is a forward-looking accounting "standard" (that is really not a standard because a standard does not offer options) that replaces the existing *incurred credit loss* approach as of Q1-2020 for large **SEC** (acronym #3) filers, all others must adopt by Q1-2023.

CECL requires banks to estimate their credit losses over the life of the loans on their books and to account for thoses losses up front! So if a bank were making 30-year mortgage loans, it would have to estimate and book its **estimated** losses on that portfolio of mortgage loans on day one!

This reminds us of Johnny Carson's Carnak the Magificent who, in character, placed a sealed envelope to his head and phsychically divined unknown answers to unseen questions.

Then along comes the Pandemic Pandemonium to which Congress reacted by the passage of the **CARES** Act (acronym #4), the Coronavirus Aid, Relief and Economic Stability Act designed to provide emergency assisitance and health care response for individuals, families and businesses affected by the Pandemic.

We always thought any bank legislation should be counter-cyclical but **CECL** is the exact opposite! Why? Simply because bankers are human and will act in a less restrained manner in their lending because their loan loss models will underestimate losses in good times just as in bad times (now) the loan loss models will call for excessive capital and loan loss reserves causing banks to exit lending when at this very time banks should be making loans when it is needed most.

Initially large banks needed to adopt **CECL** for Q1-2020 reporting while smaller banks were given a bit more time by FASB. Now big banks have until 12/31/2020 to comply and to defer impact on regulatory capital for two years before beginning the three-year phase in period, meaning a 5-year phase in. Also, according to Congress, **CARES** also pushes the deadline for small banks back to Q1-2023 and also allows small banks to use 8% rather than 9% to remain well-capitalized under the Community Bank Leverage Ratio (**CLBR**—acronym #5).

The good news is that Congress wisely understood that **CECL** was hurtful to bank lending in these troubled times and therefore it further delayed small bank/community bank implementation of **CECL** through the **CARES** Act.

We have argued over the past year that **CECL** should be repealed for all banks.

William (Bill) Isaacs, former Foley & Lardner attorney and former head of the **FDIC** (acronym #6) in a *BankThink* blog in the **American Banker** on April 24, 2020 argues likewise that for the benefit of large and small banks, **CECL** should, by act of Congress, be repealed.

FASB is a private entity, the child of accounting firms, funded and protected by the accounting industry with a board selected by the accounting industry and, without any meaningful government oversight. It needs to be eliminated and replaced by the **SEC** and a consortium of the **OCC** (acronym #7)**, FDIC** and the Federal Reserve which should set accounting standards for the banking industry.

And now for a mostly good news acronym—we used counted 7 acronyms 22 times in the previous paragraphs—the **Paycheck Protection Plan**, **PPP** (acronym #8)! We said mostly good news because as with all government programs, especially those passed in haste as the Scots poet, Robert Burns, points out in "To a Mouse", "*the best-laid plans o' mice an' men ofna' gang aft a-gley*" (a-gley = astray) And, indeed the plan has gone astray.

Just this week it was revealed (**BizTimes** enews@biztimes.com, April 28, 2020) that a publicly traded firm, Marcus Corp., which is in the hospitality business—theaters, restaurants and hotels pulled down, and especially its shareholders were bailed out by, an $11 million **PPP** loan while its **CEO** (acronym #9) made the *ultimate sacrifice* of "accepting" a 50% salary cut from $5 million to $2.5 million. There are other companies like the one cited here whose shareholders were bailed out by a forgivable loan on the backs of US tax payers like ShakeShack ($10 million) and Ruth's Chris Steak House ($20 million) to name two more visible names but both of those have elected to return their loans. And we think that franchisee/owners of the likes of ShakeShacks, Ruth's Chris, Burger King, McDonald's, Hardee's, Culver's, Holiday Inn, Marriott and Hilton which are basically small businesses should also be elegible but not their large publicly traded franchisors.

But there is plenty of good news as well. The **PPP** has highlighted the outstanding performance of community banks just like those in which we invest. From our community bank investments and community bank clients with asset bases ranging $500 million to $2 billion we've heard what we expected. A massive effort to ramp up staffing from beyond the banks' lender to others from administrative positions to accommodate the tremendous influx of interest in **PPP**, explanations to **FAQs** (acronym #10), help with the application forms (actually quite simple), review, approval and filing with **SBA** (acronym #11) through its **E-Tran** (acronym #12) system.

Since the commencement of operations on Friday, April 3, the community banks we've talked to, have approved and have had funded by the **PPP**, total loans ranging from $50 million to $200 million+. That includes delays caused by the **SBA**'s **E-Tran** system glitches. Aside from the frustrations banks have had with **E-Tran**, banks are earning fees averaging approximately 3% of the amount of the **PPP** loans they approve which are all 100% guaranteed.

Finally, President Trump, in his daily briefings since Palm Sunday has singled out community banks repeatedly for their fantastic responsiveness to the **CARES** Act, helping small businesses in the US "the engine of the economy" in our country.

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