

# THE GREAT FORBEARANCE EXPERIMENT

December 8th, 2020

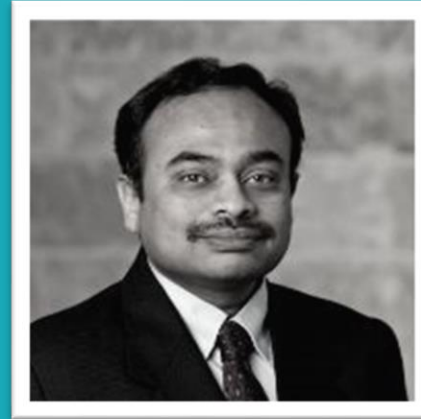
# SPEAKERS



**Nathan Stovall**  
Principal Analyst  
S&P  
Global Market Intelligence



**Bryan Corsini**  
EVP Chief Credit Officer  
Pacific Western Bank



**Amitabh Bhargava**  
Sr. Managing Director  
Credit Portfolio Management  
Strategic Risk Associates



**Albert Knotts**  
Chief Credit Officer  
Founding Partner  
Strategic Risk Associates

**Moderator**

**Michael Glotz**  
CEO  
Strategic Risk Associates



**S&P Global**  
Market Intelligence

**SRA**

# AGENDA

Welcome

Nathan Stovall

Bryan Corsini

Amitabh Bhargava & Albert Knotts

Q+A

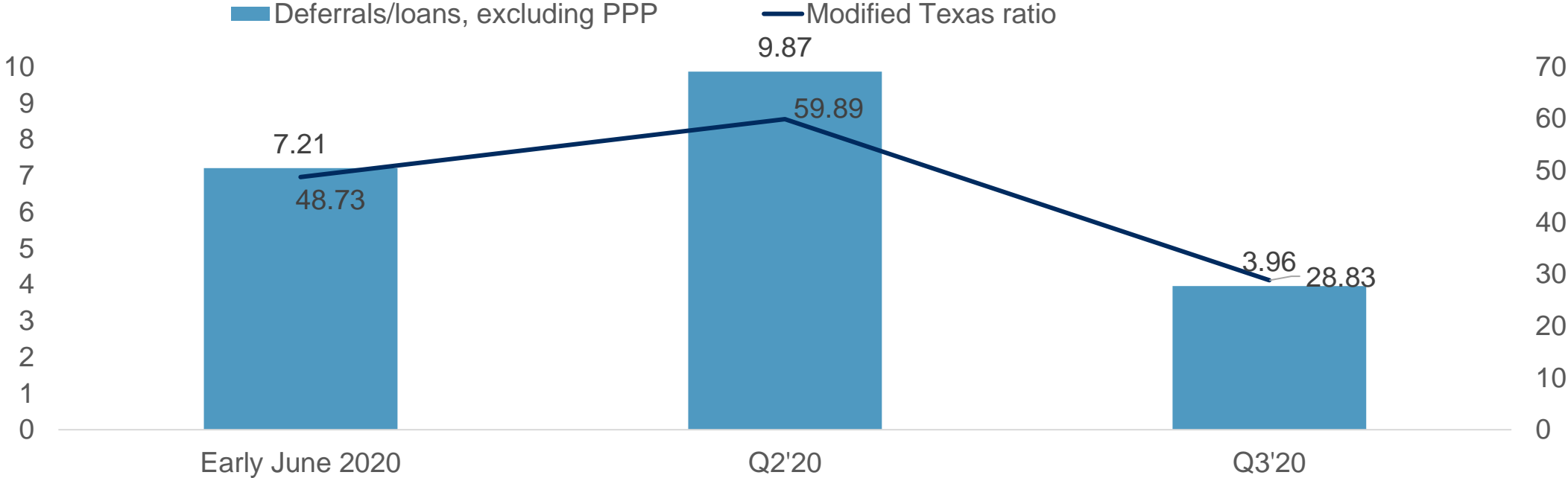
# Stimulus, forbearance soften economic blow but cloud outlook

- Congress passes \$3 trillion stimulus package, supporting unemployment insurance, small business lending.
- The Federal Reserve has nearly doubled its balance sheet, launching virtually every program from 2007-2009 and many new lending facilities.
- Loan deferrals, forbearance offered by banks reached \$1 trillion in June, offering borrowers relief but have plunged since then, falling close to 70% through Sept. 30.
- Unprecedented forbearance, Paycheck Protection Program, stimulus have propped up consumers, businesses, but support is waning.
- Divided government likely reduces chances of large stimulus package coming soon.

Data compiled Nov. 30, 2020.  
Source: S&P Global Market Intelligence

# Loan deferrals have dropped substantially in the last quarter

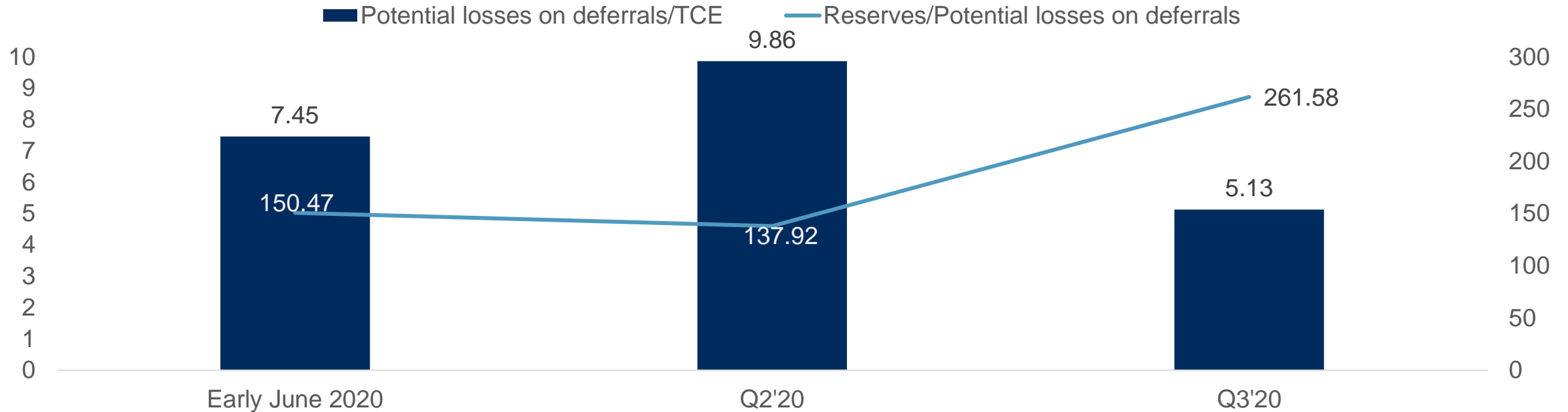
Modified Texas ratio, COVID-19 deferrals across the banking industry (%)



Data compiled Dec. 7, 2020.  
 Modified Texas ratio = Loans deferrals plus nonperforming assets plus loans 90 days or more past due/ tangible common equity plus loan loss reserves.  
 PPP = Paycheck Protection Program  
 Loans, including PPP loans, nonperforming assets, loans 90 days or more past due, tangible common equity and loan loss reserves based on the most recent quarter's data.  
 Balance sheet metrics used for the analysis in early June were based on first-quarter data, which did not include PPP loans. Balance sheet metrics used in the analysis for Q3'20 and Q2'20 were based on their respective period ends.  
 Analysis based on disclosures of publicly traded banks compiled from sell-side research reports and public filings.  
 The analysis for Q3'20 and Q2'20 was based on disclosures from more than 450 publicly traded banks. The analysis for early June 2020 was based on disclosures from 150 publicly traded banks as of June 8.  
 Sources: S&P Global Market Intelligence; Raymond James; Piper Sandler; Stephens; Janney Montgomery Scott; Hovde; Compass Point Research & Trading; Keefe Bruyette & Woods; proprietary estimates

# Bank reserves stand strong against potential losses on deferrals

Potential losses on COVID deferrals against TCE, reserves across the banking industry (%)



Data compiled Dec. 7, 2020.

TCE = Tangible common equity

Tangible common equity, reserves, loans based on the most recent quarter's data available.

Analysis based on disclosures of publicly-traded banks compiled from sell-side research reports and public filings.

Balance sheet metrics used for the analysis in early June were based on first-quarter data, which did not include PPP loans. Balance sheet metrics used in the analysis for Q3'20 and Q2'20 were based on their respective period ends.

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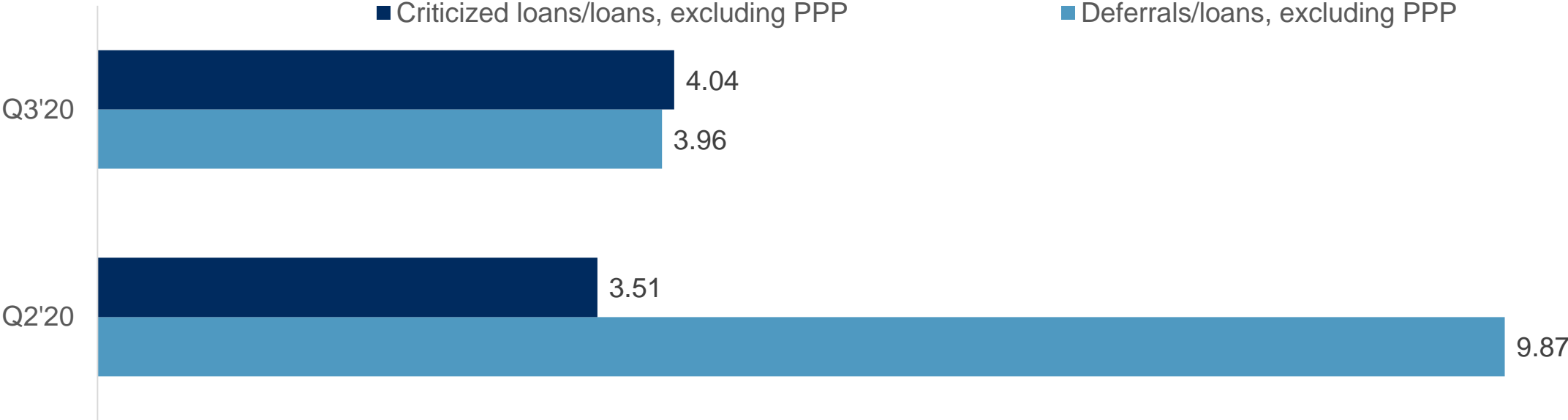
The analysis for Q3'20 and Q2'20 was based on disclosures from more than 450 publicly traded banks. The analysis for early June 2020 was based on disclosures from 150 publicly traded banks as of June 8.

Analyses assumes that 30% of deferred loans become nonperforming. Analyses assumes losses on nonperformers would be the average of each group's loss experience from 2007-2009 and loss given default on assets at failed banks during the Great Recession.

Sources: S&P Global Market Intelligence; Raymond James; Piper Sandler; Stephens; Janney Montgomery Scott; Hovde; Compass Point Research & Trading; Keefe Bruyette & Woods; proprietary estimates

# As loan deferrals have plunged, criticized loans have risen modestly

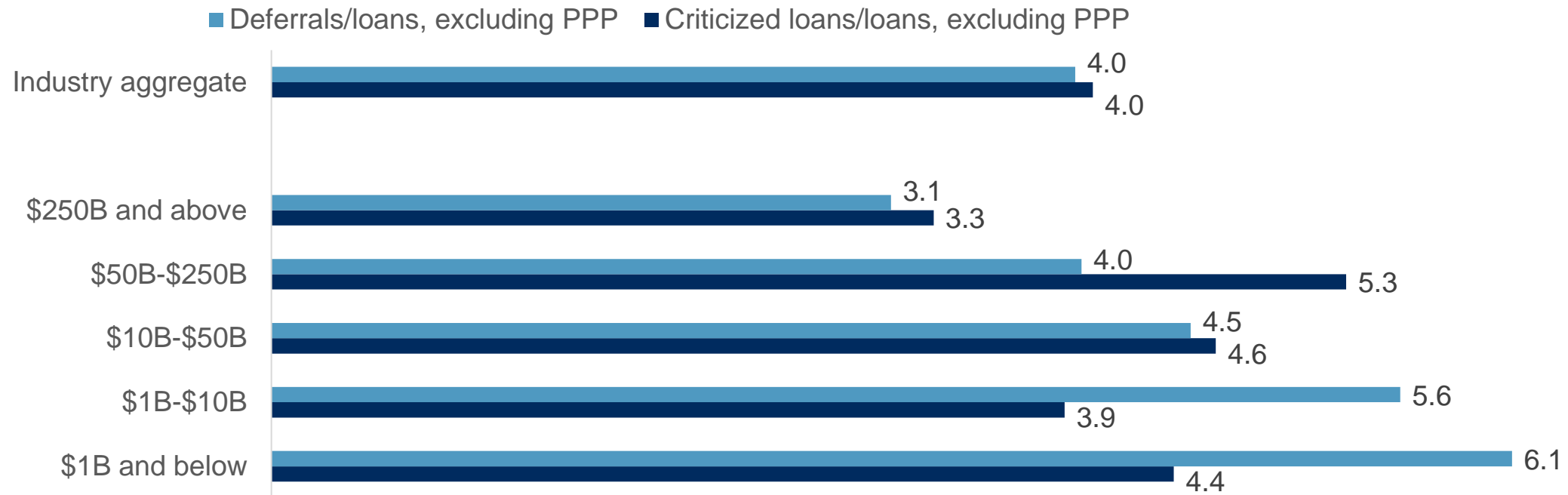
COVID-19 deferrals, criticized loans across the banking industry (%)



Data compiled Dec. 7, 2020.  
Criticized loans = Loans that are categorized by the company as special mention, substandard, doubtful or loss.  
PPP = Paycheck Protection Program  
Balance sheet metrics used in the analysis for Q3'20 and Q2'20 were based on their respective period ends.  
Analysis based on disclosures of publicly-traded banks compiled from public filings.  
The analysis for Q3'20 and Q2'20 were based on disclosures from more than 450 publicly traded banks.  
Sources: S&P Global Market Intelligence; proprietary estimates

# Small banks lead the way in deferrals, but criticized loans more widely distributed

Criticized loans, COVID-19 deferrals by asset group as of Sept. 30, 2020 (%)



Data compiled Dec. 7, 2020.

Criticized loans = Loans that are categorized by the company as special mention, substandard, doubtful or loss.

PPP = Paycheck Protection Program

Balance sheet metrics used in the analysis for Q3'20 and Q2'20 were based on their respective period ends.

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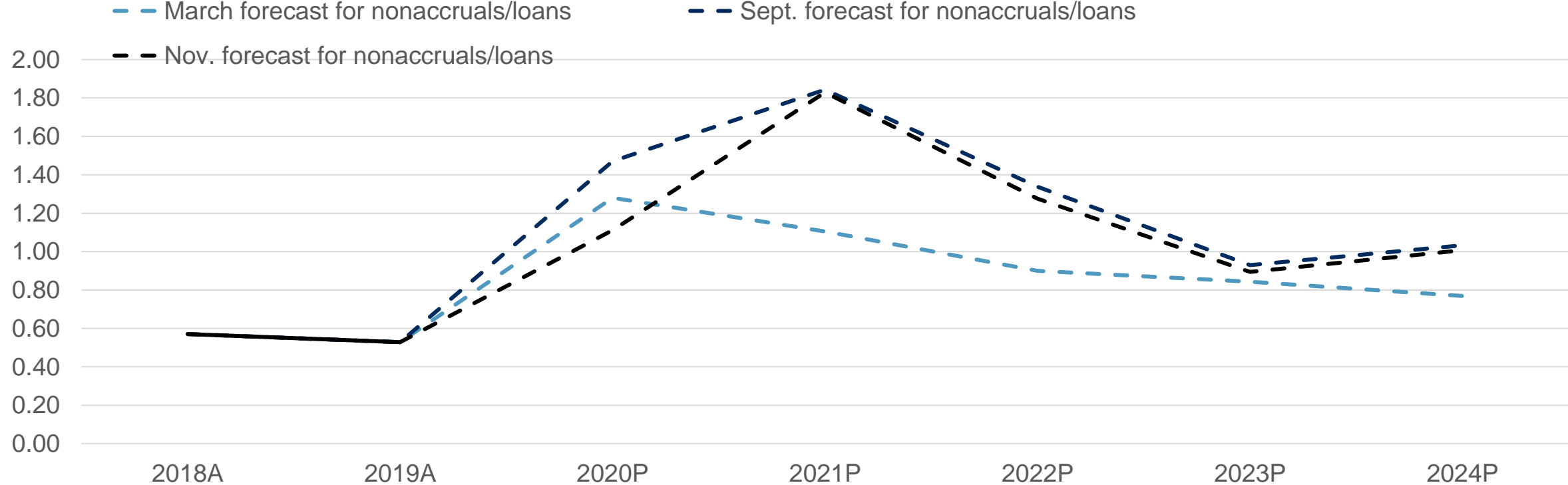
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Sources: S&P Global Market Intelligence; proprietary estimates



# Stimulus, forbearance delaying credit slippage, but vaccines could temper long-term losses

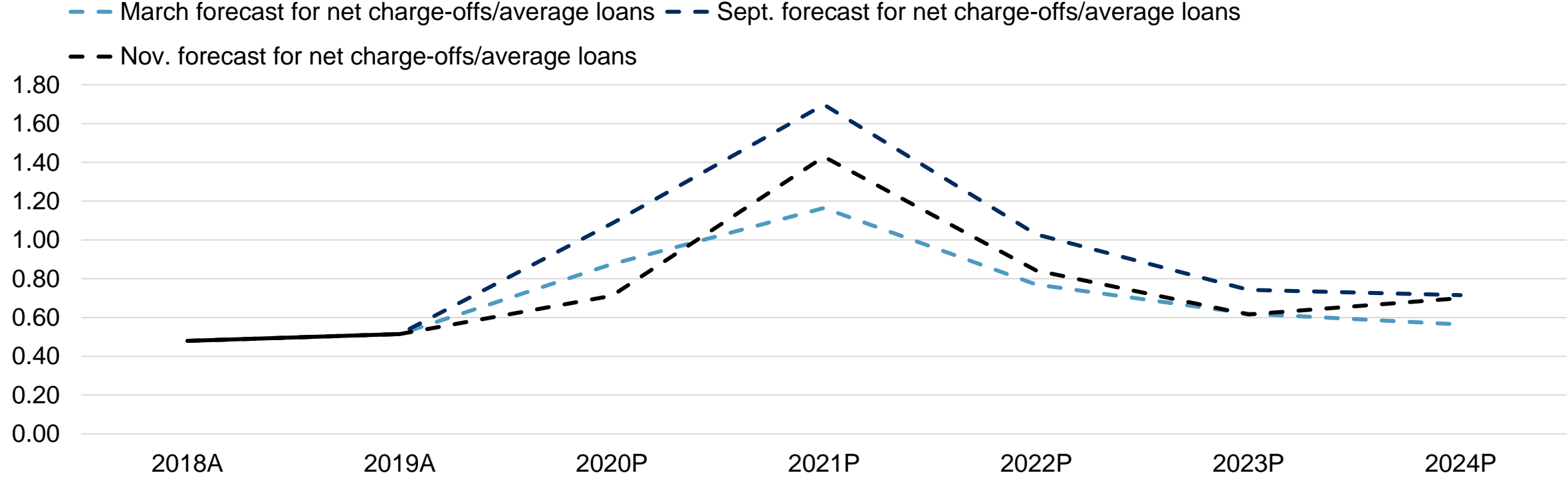
Nonaccruals/loans (%)



November forecast current as of Nov. 30, 2020.  
 September forecast current as of Sept. 8, 2020.  
 March forecast compiled on March 19, 2020.  
 A = actual; P= projected  
 Sources: S&P Global Market Intelligence; proprietary estimates

# Stimulus, forbearance delaying credit slippage, but vaccines could temper long-term losses

Net charge-offs/average loans (%)



November forecast current as of Nov. 30, 2020.  
 September forecast current as of Sept. 8, 2020.  
 March forecast compiled on March 19, 2020.  
 A = actual; P= projected  
 Sources: S&P Global Market Intelligence; proprietary estimates

# Borrowers still seeking relief are in at-risk industries

- Many borrowers that have asked for a second deferral period operate in the hospitality, retail and restaurant sectors.
- COVID-19 has disproportionately impacted those sectors.
- Leisure and hospitality sectors have produced the greatest job losses. U.S. revenue per room, or RevPAR, expected to be down 50% in 2020, according to S&P Global Ratings. A recovery is expected in 2021 but RevPAR will still remain 20% to 30% below pre-pandemic levels.
- Banks say they are eying re-deferrals with great trepidation and have worked to mitigate losses.

Data compiled Nov. 30, 2020.  
Source: S&P Global Market Intelligence

**BRYAN CORSINI**  
**EVP CHIEF CREDIT OFFICER**  
**PACIFIC WESTERN BANK**

# Great Recession vs Pandemic

	<u>2008 Great Recession</u>	<u>2020 Pandemic</u>
<u>Pre-Crisis</u>	Build-up of imbalances -Run-up of credit/housing -Thinly capitalized (shadow) banks	Well balanced -US gov. debt expansion -Corporate debt
<u>Trigger</u>	Re-evaluation: real estate -Regional correlation	Pandemic induced rapid deceleration of economic activity - Corporate cash flow crash - Pre-pandemic strong and weak borrowers alike are impacted
<u>Amplification</u>	HH and Banks' Balance sheet	Corporate sector balance sheet
<u>Who needed bailout</u>	Banks	Borrower
<u>Policy Objective</u>	Demand Stimulus	Survival
<u>Bailout Speed</u>	Fast	Extremely Fast, Reg and Accounting reaction very accommodating <b>SO FAR</b>

- Just like 2008 it takes time for the credit impact to play out
- Forbearance last time usually resulted in the lender improving its position – not for free

# Current State

- Stimulus programs have been very effective
- Industry winners and losers
- Financial firms have analyzed their portfolios, increased reserves, and worked with borrowers
- Forward-looking stress tests, accurate risk ratings, new loans to strong borrowers
- Deferrals vs large “R” forbearance

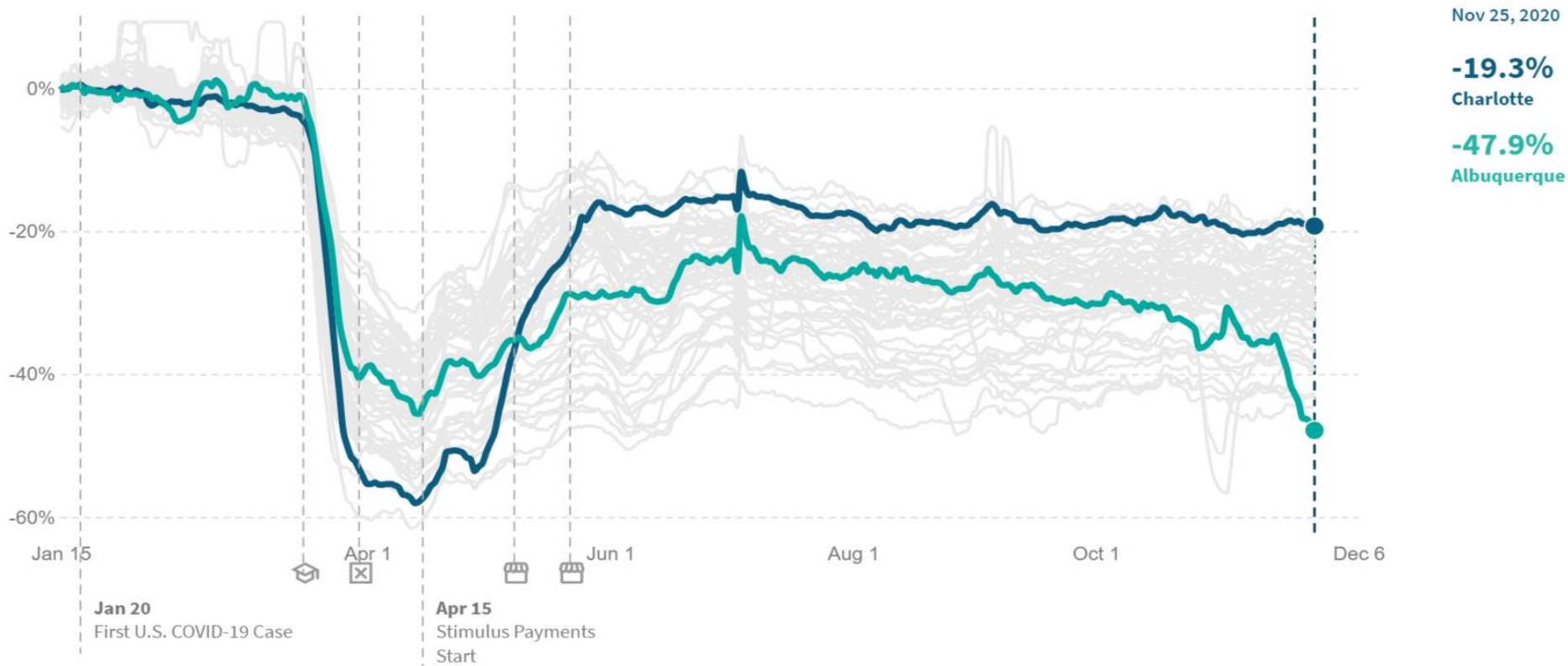
Opportunity to enhance reputation with customers

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# Epidemiological impact and local administration response varies across metros

## Percent Change in Number of Small Businesses Open\*

In **Charlotte**, as of **November 25, 2020**, the number of small businesses open **decreased** by **19.3%** compared to January 2020.

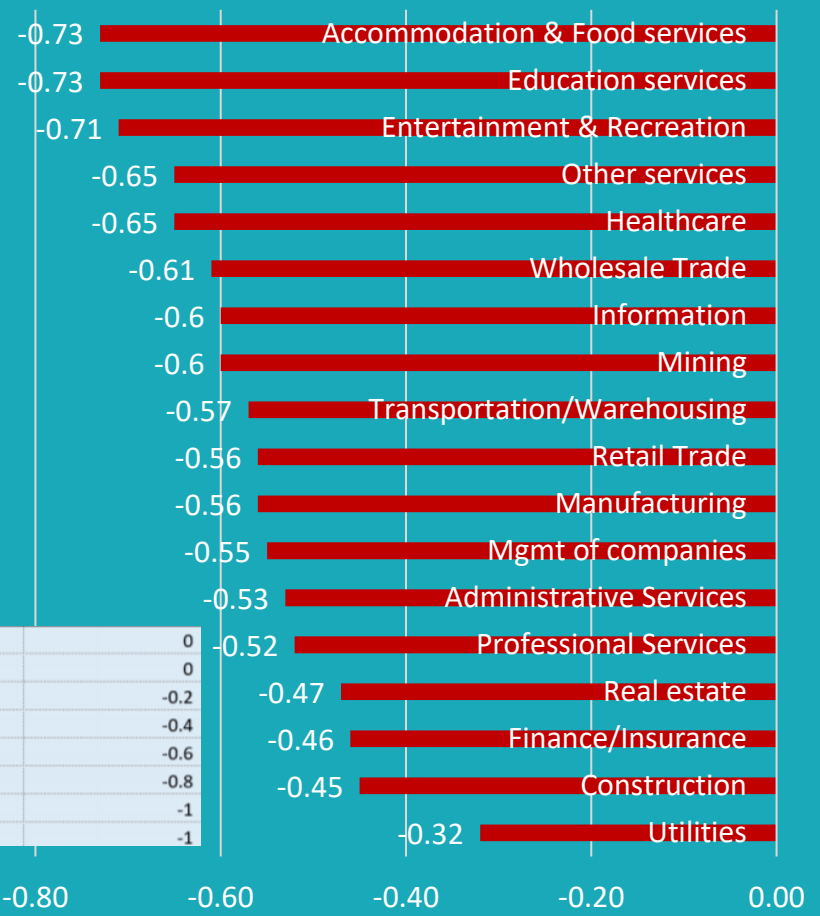


\*Change in small businesses open (defined as having financial transaction activity), indexed to January 4-31 2020 and seasonally adjusted. This series is based on data from Womply.

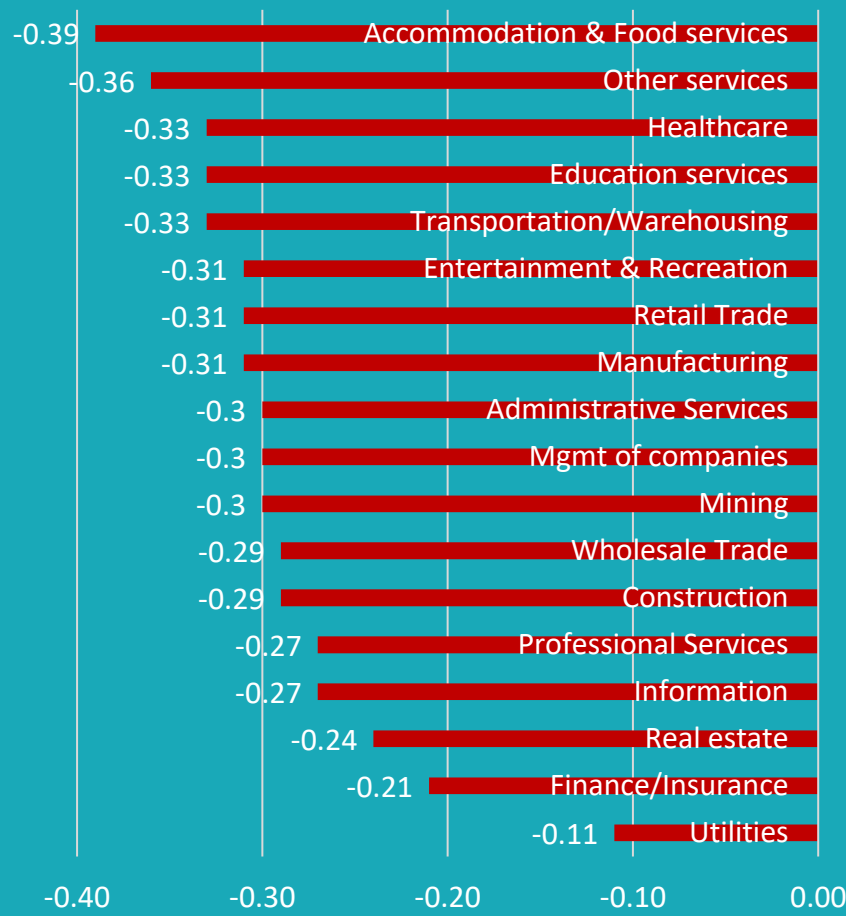
last updated: **December 04, 2020** next update expected: **December 11, 2020**

# Forbearance programs have mitigated Financial stress, but recovery prospects stay weak and disparate across sectors

Recovery Index



Financial Stress Index



Little or no impact	0
Returned to normal	0
1 month or less	-0.2
2-3 months	-0.4
4-6 months	-0.6
More than 6 months	-0.8
Never	-1
Permanent close	-1



Source: Small Business Pulse Survey- Census Bureau- Data collected Nov 23-29



# Deferral, Forbearance, Collection Best Practices

- Payment option programs supported by a disciplined and well documented process
- Accurate risk ratings
- Customer communication should be crystal clear
- Deferrals are a little “r” restructuring
- Big “R” restructuring requires a formal Forbearance agreement – reservation of rights, waiver of lender liability, and an improvement in the lenders position (right size the loan)
- Workout talent, legal support, accounting support, information, digital, expenses, policies and procedures
- Plan the RR upgrade or exit strategy

# Forward Looking

- Some borrower business models will be permanently compromised
- Deferrals will convert to large “R” forbearance and TDRs
- A and B note solutions
- Bulk sale of vulnerable loans
- Avoid surprises and don’t surprise examiners
- Strong borrowers in weak industries will benefit from a vaccine
- Clean, efficient, agile, and strong

# Geographic and sectoral analytics can aid in refining monitoring of deferral programs and finetuning exit strategies

## Geographic Health Score

Credit Quality Index

Employment Index

Demographics Index

Business activity Index

Income Index

Housing Index

Cross-sectional Health score  
How does economic health of select MSAs compare to 390 MSAs in the country?

Time series Health score  
How does economic health of select MSAs compare to 30-year averages?

## Sectoral Health Score

TTC Credit volatility/resilience

Recent Performance

Short term outlook

Long term outlook

Historical trends in employment and credit quality

Multifactor analysis using bespoke factors that are determinants of an industry's health

Factors encompass quantitative variable (economic variables and industry specific performance indicators) and qualitative assessments

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# QUESTIONS

# TOP TAKE A WAYS

# THANK YOU!

Please fill out the survey  
as the webinar concludes

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