Managing Your Credits Through the Crisis

As economies begin to reopen, it is difficult to quantify the full impact of the coronavirus pandemic and the economic shutdown on the credit portfolios of banks. It is unlikely we will be able to fully quantify the impact for some time; we will wait to see which industries are successful in reopening and adjusting to the new normal with social distancing, and which industries continue to struggle (e.g., airlines, travel, commercial real estate, small businesses). We cannot be certain how severe or mild the impact will be, but there will be impacts on banks' credit portfolios.

The US government has gone to extensive lengths to help banks and Main Street borrowers through these challenging times. The Federal Reserve has extended its Main Street Lending Program. The US Treasury has made over $400 billion available through the Small Business Administration's Paycheck Protection Program. These programs not only aim to help borrowers and lenders weather the storm, but also put in perspective how broad the current crisis is and how difficult it is to forecast the impact on banks' balance sheets and income statements. Therefore, banks need to prepare for potential losses and begin managing their credits actively for the period when government backstops expire.

What does it mean to actively manage their credits?

The great consulting answer is "It depends"; but it starts with conversations between the bank and the borrower. Banks need to understand the individual situation the borrower finds him/herself in. In these unprecedented times, banks should not be making blanket decisions on their loan portfolios and should instead manage the individual loans.

Borrowers should repay their loans if can. If the borrower is having difficulty (as many are), banks should work with the borrower to provide the best options available but also ensure the bank does not incur extensive losses in the process. Regulators and legislators have been quick to provide guidance and relief (e.g., the CARES Act allows mortgage forbearance for six months and commercial loans for three months).

The bank should create for its borrowers plans that can take the form of restructuring the debt, further forbearance, or workout of the credit. A restructuring plan should include a review of the borrower's prospects for future ability to repay, based on the current state of affairs and the bank's assessment of the borrower's business resuming its prior successes. If the situation is still unclear and continues to be in flux, then the bank may consider further debt forbearance while the borrower reviews his/her options. Banks should ensure they place specific time limits on the forbearance period and regularly check-in with the borrower; this is good customer service and will limit surprises as the forbearance period expires.

Given the extenuating circumstances, foreclosure and workout likely should be seen as last-resort options for the bank and the borrower. However, they may be necessary, particularly as protections run out. Therefore, the bank should uphold the covenants of the loan contract and recuperate as much as possible to reduce its potential loss.

Internal coordination

While the coordination between the borrower and the bank is a primary focus of the credit teams, many internal stakeholders should be consulted and kept abreast of the situation. Outside of a continuing repayment of the loan, each option mentioned above has impacts on bank resources, including accounting teams, credit teams, IT systems and teams, operations staff, and the bank's financials. Therefore, communication and coordination within the bank is key to limit issues for customers and reduce internal issues related to misclassifying a loan on an accounting system or classifying the borrower inappropriately as in default for credit reporting purposes.

We recommend that the credit committee of the bank take an active role in the coordination and ensure the appropriate tools and systems are put in place. The credit committee should:

- Establish a cross-function program management office to coordinate across stakeholders;
- Ensure the stakeholders have the necessary communication materials (e.g., client script, appropriate mailers);
- Enable an agile IT development schedule to ensure enhancements are made quickly; and
- Develop a checklist to ensure—as changes are made to loans with customers—that the necessary changes are made to accounting systems, originations systems, and reports.

Conclusion

This economic downturn is different from previous downturns for many reasons, but one reason stands out: It did not begin in one industry or region and spread contagion, as we have seen in other crises. It has been broad and impactful, affecting borrowers and their financial institutions at the same time. Therefore, the levels of communication, coordination, and cooperation need to be higher to help all of us come out on the other side positioned for success.

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