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How Are Credit Markets and Institutional Banks Responding to COVID-19? A Q&A Session with Nathan Agens of PNC Bank, National Association

Articles, COVID 19: Answers to Business Challenges May 8, 2020

This is the second in a series of interviews with professionals to share information about how their businesses are reacting to COVID-19. Jordan Blask, Eric Schumann, and Edward Grattan of Tucker Arensberg, P.C. were the interviewers.

Over the last month or so, various facets of the American economy have been quickly overwhelmed by the numerous effects of the COVID-19 pandemic. For the second interview in our series of interviews with local business leaders regarding the impact of COVID-19 on the economy, Jordan Blask, Eric Schumann, and Edward Grattan, business, credit, and finance attorneys, at Tucker Arensberg, P.C., a Pittsburgh based law firm that represents clients both regionally and nationally, "sat down" via Zoom Meetings, with Nathan Agens, of PNC Bank, National Association's ("PNC") Asset and Liability Management Group to provide his perspective and outlook related to the effects of COVID-19 on the banking industry.

Nathan Agens is a Managing Director in PNC's Asset and Liability Management Group. Nathan's group primarily manages the firm's only daily regulatory requirement, the Liquidity Coverage Ratio, which was implemented after the 2008-2009 financial crisis. One of his primary roles at PNC is to understand the bank's borrowing needs and then evaluating the best source of that borrowing for the bank whether it be through engaging with their capital markets teams and looking at issuing unsecured debt in the bond market, borrowing from other banks in the fed funds market, issuing commercial paper, or entering into repo transactions versus running deposit promotions in featured markets. Nathan joined PNC in 2005 and was a fed funds trader that oversaw daily fund flows between banks. Over the course of Nathan's career, Nathan has held a couple of different jobs in a treasury type capacity and his primary focus has been on the deposits and funding aspects of PNC's day to day institutional operations.

Question from Tucker Arensberg: Can you provide us a high level analysis of what the banking environment was like going into the great recession versus now with a view towards the pandemic's impact on the banking world? And as a corollary to that, I know that the banks have been following the CARES Act and all of the additional COVID-19 legislation, so what is the buzz within the banking world from where you sit?

Nathan: This has been a very fascinating period if nothing else from the fact that a lot of the programs that were utilized during the 2008-2009 crisis, to stabilize markets, were used by the fed and other regulators by copying, pasting and implementing similar programs in a very short order when they put together the CARES Act. The last time around it may have taken years to get these programs up and running. In response to this current crisis, in a matter of weeks, you had a vast majority of those programs up and running. Relative to the CARES Act specifically, my piece is primarily understanding what it means for our deposit flows. So we have been spending a lot of time thinking about what this crisis means if people are getting laid off. You aren't going to see normal pay days on the 1st and the 15th. We are watching the combination of unemployment insurance plus stimulus through the CARES Act and what that means from both a savings perspective and a spend perspective across our balance sheet. So we have been focusing a lot on that aspect and near term implications as well. Loan defaults seem secondary to cash flows right now as the legislation being passed places a moratorium on most collection activities.

Question from Tucker Arensberg: Do you anticipate much by the way of reduction of deposits where businesses and individuals need to draw down from their savings. I'm not talking about the bank run situation but, just with the use of the funds, I'm wondering does that money come back around and get redeposited at some point?

Nathan: Yeah, it's the right question. I'll separate my answer into two parts because I think you have to segregate out the consumer business and the commercial business. On the consumer side there is clearly a focus – there is a lot of uncertainty around this – what type of unemployment levels we are going to see and what that means for our deposit projections. If I had to just guess, I'm guessing that it's probably a net positive overall. You may have some more risk adverse folks kind of moving money out of the markets and into savings and that helps offset some of the reduced deposit flows you might see from just a normal unemployment cycle.

On the commercial side, I suspect at least in the initial stages, of what we are seeing so far, a lot of corporate entities are drawing down their facilities right now. They are drawing down their lines and they don't have a specific purpose for that draw down. They just want to bolster liquidity. They tend to let that money sit back on deposits in the banks. PNC, as a large commercial lender, we have seen a little bit more loan growth than we have deposit growth, but I think across the industry it varies from what we are seeing. The longer this goes on, the more that these corporations will start to utilize those deposits.

Question from Tucker Arensberg: Can you provide us some more perspective on what you expect to see in terms of loan growth – will it be a short term blip?

Nathan: It is really interesting and again, I think it is all circling back to the last financial crisis and people having short term memories. Everything seems to be moving much faster this time around. I think as people start to see access to normal financing channels, whether that's the commercial paper market or borrowing in the long term on secured debt markets, close off or become much more expensive, companies will first start to draw down on their facilities. We already saw that through the news cycle where Fortune 500 companies were reporting that they were actively drawing down on their lines. As the liquidity crunch starts to flow downstream into the middle market companies, non-profits, and government entities, those types of businesses will ultimately push new loan originations. In fact, through late March and April, it felt like we were seeing a significant amount of loan growth but that growth is starting to slow down a little bit as some of these stimulus actions are starting to take hold. The one thing that we have seen start to open up is the corporate bond market. There has been a significant amount of investment grade issuances over the past month or so. So despite the expected increase in borrowing costs, those markets are functioning and companies are certainly taking advantage of that and getting cash in the door.

Question from Tucker Arensberg: Do you anticipate that banks will have any difficulty obtaining financing that they need for funds liquidity?

Nathan: Yeah, that's also a good question. One of the first things the regulators did is that they opened up the discount window. This is generally thought of as kind of the last resort for banks to go borrow directly from the Federal Reserve but, the Fed has been overly accommodative by making the terms very friendly and very inexpensive. They also reduced the amount of transparency in fed reporting, so that you can't easily discern who is borrowing money at the window. They have been overly accommodating on that front and I think if this were to drag on for a significant amount of time, you would see more usage of those types of facilities. I don't think banks will have any material problems with meeting their financing needs.

Question from Tucker Arensberg: Is the reason they are reducing the "transparency" as you said, because they don't want to create stock pressure for the financial institutions? What is the impetus behind their move?

Nathan: There has always been a negative stigma around a financial institution's use of the Fed discount window and similarly on any reliance on the government to support banks. It's always been thought of as a sign of weakness and I think the Fed is just trying to be as accommodative as possible so you don't see a run on banks, or to your point, significant pressure on stock prices.

Question from Tucker Arensberg: Assuming that the banks have sufficient and reliable access to funds, how do you anticipate PNC using its existing capital and/or this newly accessible capital within the lending markets?

Nathan: I think it's what we are living right now – constant loan growth over the last month and a half. I think what the regulators want to ultimately do is to keep encouraging lending activity. They have been very helpful not just with the discount window but, there has been other levers that they have opened up just to make sure banks can continue to lend. There are even a couple of things that are left over from the 2009 financial crisis that they haven't done yet. One of the things the CARES Act did is that it opened the door for the FDIC. Some of the things they used during the last crisis were unlimited FDIC insurance on transaction deposits and they also implemented a government guaranty on unsecured debt issuance. We could certainly see that happen again.

Question from Tucker Arensberg: As we start to see what this pseudo-financial crisis has in store for the economy, are there things that came out of the last set of financial regulations from the 2008/2009 crisis that are now being viewed as a burden to the banks which may create hurdles to them being able to provide lending relief during this current pandemic situation?

Nathan: One of the things I've been thinking about are the TLAC requirements. TLAC stands for Total Loss-Absorbing Capacity. It's something PNC is not subject to, but all of the large global banks are subject to it, and it is effectively a requirement that makes banks have enough unsecured debt as a percentage of assets that will enable a bank to weather a financial downturn by looking to its own balance sheet without requiring a public bailout. That has been really challenging for banks that are subject to this requirement. They have seen all of this loan growth, and they've seen their balance sheets expand significantly in the last month but they still have to meet the TLAC requirement. So some of them have been issuing debt in the corporate markets over the past month but at egregious spreads. They're not doing like 2 or 3 year bonds, they're doing like 10 or 30 year bonds, so these are long-term obligations that they will be lugging around for a long time, and are largely driven by this TLAC requirement. So, that's one that will certainly put pressure on banks as they deal with today's financial stress.

Question from Tucker Arensberg: In light of everything you are seeing, what's one of the more important things on your radar screen over the next few months?

Nathan: So my job focuses on liquidity management for PNC, and it has been fascinating to me to see the level of loan growth in response to the pandemic and to see how borrowers are using their committed lines of credit. All of that loan growth intersects with the regulatory metric that I am most responsible for which is the Liquidity Coverage Ratio or "LCR".

Question from Tucker Arensberg: Could you give us a "101" on the Liquidity Coverage Ratio and what that means in relation to your job and to PNC?

Nathan: So the LCR was something that was put in place after the 2007-2009 period to ensure that banks had enough liquidity to commit to their lending obligations if there was a period of financial stress. It went live in 2015 and PNC has been subject to it since that time period. In effect, what it is, is that it makes banks look at their main sources and uses of liquidity. The main source for us is our deposit book and how much of that we would expect to leave in a period of stress. PNC is a large commercial bank, the vast majority of our LCR requirement is driven by our deposit book and just the assumptions that are built around that decide how much could potentially leave. So of course the numerator of the equation is the amount of liquidity we have on hand and that's defined as kind of a combination of the cash balances that we carry, as well as, our higher quality of investments we carry in our portfolio, like treasuries and certain securities. On a daily basis, a bank that is subject to the requirement, has to assess how many high-quality liquid assets it has relative to its net cash outflows, and that's what my team manages. What is interesting to me is that while we are obligated to manage our LCR to 100% of potential outflow, the regulators are beginning to suggest or encourage that we use our liquidity buffer within the financial markets in conjunction with lending decisions.

Question from Tucker Arensberg: What accommodations have there been to loosen up any restrictions that the banks might be feeling because of the capital rules under Dodd-Frank?

Nathan: I guess specifically speaking to the liquidity side, we saw CECL (Current Expected Credit Loss) reporting get delayed, which I think helps. The scope of the horizontal liquidity reviews, which banks are subject to every year, were downsized. CCAR (Comprehensive Capital Analysis and Review) is still on time, but it feels like CCAR is going to be a mini test versus the usual test. So, I think that the regulators are trying to focus on the real issues, the current problems, and maybe delay some of the regulations that are in motion.

Question from Tucker Arensberg: The FDIC published some frequently asked questions that included some guidance or encouragement to make payment accommodations or deferrals on amortization of loans. How do such accommodations affect your policies that are set by regulatory mandates as to how you report the quality of your assets or the quality of your lending relationships?

Nathan: I think they are trying to ease up the troubled loan status and just all the negative impacts that it has on your capital ratios; on your FDIC assessments, on your various ratios reported externally. I'm not as close as to how it's actually being implemented, on a loan-by-loan basis, but I think at the end of the day, they are certainly trying to help ease these issues and help banks get through it.

Question from Tucker Arensberg: **Could you touch on LIBOR and its relationship with your department and the COVID-19 pandemic?**

Nathan: I don't know how much you all are paying attention to the LIBOR cessation; effectively, LIBOR is set to go away at the end of 2021. I think this crisis throws a big wrench into that situation. The chosen rate that's going to succeed LIBOR is SOFR (Secured Overnight Financing Rate). It's effectively a risk free rate. It's tied to transactions with government collateral. The SOFR rate over the last week or so has been down close to zero and the LIBOR rate is up well above 1%. SOFR just isn't a very good lending benchmark because when you're going through a period of stress, and bank funding costs are going up, all of a sudden, our lending – the rate that we're lending at – is going down. So it's the exact opposite of what you want to see happen. Historically, large commercial banks such as PNC, have had the vast majority of their facilities tied to LIBOR, which is risk sensitive and makes for a good lending benchmark for banks. So there's been a lot of focus on this over the past couple of months, primarily led by the regional banks, on finding a different benchmark for lending in a non-LIBOR environment. The importance of the risk versus non-risk indexed rate during a period of financial stress such as the one we are currently facing is even more significant.

Question from Tucker Arensberg: Nathan, as our parting thought, could you give us any perspective on what you would anticipate being the lasting impact from COVID-19 on the banks and financial institutions?

Nathan: One of the macro-trends which I have seen is that the larger, more sophisticated financial institutions have had a really significant advantage over the smaller local banks when it comes to deposit growth which in fact expands further in times of financial stress like what we are facing with COVID-19. The larger banks have better online presence and a more national reach. They end up with more cash on deposit. The strength of these large banks will naturally cause pressure on smaller community banks as customers flock to the perceived safety of big banks. This in turn could result in further consolidation of banking within the United States.

Thank you to Nathan Agens of PNC Bank for sharing his insights on how the banking industry is reacting to COVID-19. Please check back soon for our next interview which will be focused on the manufacturing industry. If you have suggestions for interview topics or professionals, please contact Jordan Blask.

About Nathan Agens

Nathan is a Managing Director at PNC Bank, NA a diversified financial services company engaged in retail banking, corporate and institutional banking, and asset management. Nathan joined PNC in 2005 as an associate in the Asset and Liability Management group based in Pittsburgh and was promoted to Vice President in 2015. During that period, Nathan held various positions responsible for executing PNC's funding plan, debt issuance, regulatory compliance, and working across the organization to better optimize the firm's balance sheet. In 2015, Nathan's responsibilities expanded to include developing and implementing the firm's funding strategy and managing a team responsible for compliance with emerging liquidity regulations. In 2019, Nathan was promoted to his current role as Managing Director of the Liquidity Management team. Prior to joining PNC, Nathan served in the U.S. Army and Pennsylvania Army National Guard. During this time, Nathan served for four years on active duty, including two deployments in support of Operation Iraqi and Operation Enduring Freedom where he was awarded the Bronze Star and Army Combat Action Badge. He holds a Bachelor's of Business Administration degree and Masters of Business Administration from the University of Pittsburgh. Additionally, Nathan is a Chartered Financial Analyst (CFA) and member of the CFA Society of Pittsburgh. Nathan can be contacted at 412-762-0791 or via email at nathan.agens@pnc.com. To learn more about PNC Bank visit them at www.pnc.com.

About the Interviewers

Jordan Blask serves as the Co-Chair of Tucker Arensberg's Bankruptcy and Creditors' Rights Department. He a member of the firm's Board of Directors, and its Chief Compliance Officer. Jordan is the shareholder in charge of the firm's COVID-19 Rapid Response Team and is the curator of Tucker Arensberg's COVID-19 "Answers to Business Challenges" blog. Jordan can be reached at 412-504-5597 or via email at jblask@tuckerlaw.com.

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