FDIC PODCAST

Episode 1: The State of Banking – COVID-19 Edition

BRIAN SULLIVAN: Welcome to the FDIC Podcast. A new offering from the Federal Deposit Insurance Corporation, to hear from the nation's top banking regulators and thought leaders about the financial sector, our banking system, and even your bank.

Since the last economic crisis of more than a decade ago, banks have recovered pretty well. Earnings reached record highs. Capital levels were healthy. But then our world changed rather suddenly earlier this year with the global pandemic that shocked the system. COVID-19 is not only a public health emergency, it also shut down large portions of our global and our national economies.

What does this mean for our banks? Here to discuss the state of the banking sector in these uncertain times is Jelena McWilliams, the chairman of the Federal Deposit Insurance Corporation. Hers is a unique story which we'll get to in just a moment. Madam Chairman, thank you for being with us.

JELENA MCWILLIAMS: Thank you so much, Brian, for having me on our first inaugural podcast.

BRIAN SULLIVAN: What is the state of our banks today?

JELENA MCWILLIAMS: So we are in the middle of June of this year, for those of you who are listening and maybe listening a month later, and we have just released our first Quarterly Banking Profile from the beginning of this year, from the first quarter that shows us how the industry has fared in the first quarter. And as you recall, we had the pandemic, it was declared sometime in February, early March. So, for the first quarter, as we're looking at the data points, it captured about one month of the pandemic out of the three months.

And surprisingly, actually, banks are doing rather well. There has been a significant decrease in their net operating income. They had to set aside more money for provisioning, for credit losses…but at the same time, their balance sheets are very strong. They have been able to absorb the initial shock to the economy rather well.

And I like to remind people that unlike the 2008 crisis, *this* crisis was not driven by poor underwriting standards. It was driven by a health crisis, by a pandemic, that resulted in economic shutdowns throughout the country, and frankly the world, that is now turning into a formal financial crisis and we need to do whatever we can on the regulatory side to make sure that it doesn't become a full-blown financial and economic crisis.

So, it's been important for us at the FDIC to make sure that banks are able to do what they need to do to continue to provide credit and lend to the economy. Namely, to be able to modify loans for customers who have lost jobs or who have seen a reduction in their incomes. And generally being able to work with the communities as everybody's suffering at this time.

BRIAN SULLIVAN: But are banks still lending? Are they still investing? Are they still functioning?

JELENA MCWILLIAMS: Yes, they are. Absolutely. They're doing a tremendous amount of lending. They are investing in their communities. They're able to modify loans because they have strong balance sheets and they're able to do loan modifications for their customers well in advance of the customer being fired or furloughed or laid off because of the economic shutdowns throughout the country. So, banks have really been on the forefront of - I would say economic recovery in the past couple of months with the lending and other activities they're doing in their communities.

BRIAN SULLIVAN: How about those families and small businesses that are maybe on the lower-income side and they desperately need financing to weather this storm…are banks serving them, in particular?

JELENA MCWILLIAMS: Yes. So, we have seen banks serving them as well. These are the so-called low- and moderate-income communities. And when you look at the Fed's survey from, I believe back in April or early May, they have surveyed about 1200 households. And found out that about 39% of the households making under $40,000 a year have lost income or been furloughed in the month of March. So, when you think about it, almost 40% of household individuals making under $40,000 a year, don't have a job as of March.

And so, it was important for us at the FDIC to make sure that the low- and moderate-income communities, in particular, are able to access credit very quickly through banks, because we can supervise banks for consumer compliance. And we certainly believe that more competition in the marketplace is good for the consumer and drives the cost of those products down.

So, we have been able to work with our sister agencies, the Office of the Comptroller of the Currency and the Federal Reserve Board of Governors, to issue a-a joint guidance document on-on so-called small-dollar lending. These are small-dollar loans, several hundred dollars to several thousand dollars that are unsecured that are usually short term. And we were concerned that without a joint guidance that we frankly didn't have before among the three agencies, that banks would be unwilling to take the risk of lending to the low and moderate-income communities on unsecured basis. So that was one of the initiatives we did to make sure banks are in this space.

We also issued uh guidance encouraging banks for the purposes of Community Reinvestment Act to serve the low- and moderate-income communities. And we're thinking how we can give them additional credit for the purposes of the CRA in that space if they are very proactive with those communities.

BRIAN SULLIVAN: Now it's this segment of the marketplace, the low- and moderate-income households, that resonates with you in particular. We- mentioned before, yours is a unique story. Why is that part of the marketplace so important to you?

JELENA MCWILLIAMS: It is actually extremely important to me and here's why. I wasn't born and raised in the United States. And I came to the United States as an exchange student at the age of 18 with $500 in my pocket. And I lived with a host family, but pretty soon the $500 dried up. And when I moved out of my host family's house, I had a series of minimum wage jobs, making $4.25 cents an hour. This was back in the early nineties.

And quite often I would be left with about $20, $25 a month for food. And when you have that little money a month for food, you kind of start thinking about your basic priorities in life. And you-you start thinking about, not about the safety net. You know, we talk about a safety net for consumers, everyone should have six months of bills to pay saved up in a banking account. But when you don't have much and you don't have means of making much, the $25 all of a sudden becomes much bigger than $25. It becomes the difference in you being able to feed yourself or not feed yourself.

And so that's the part of the story in this economic, I would say, *crisis* caused by the pandemic, that frankly has resonated with me personally, on a very deep and profound level. At that point in time, I was by myself. So, I had just had to feed myself, but I can only imagine how difficult it is as a mother and a father to not being able to feed your children or not being able to provide something basic that your family needs.

So, it is important to me that we are able to respond to the needs for the low- and moderate-income community, because frankly they have been the hardest hit by the economic shutdowns. And they will take the longest to recover, because they do not have the safety net. So, we need banks to be in this space and do responsible lending to these families and individuals because their very survival may depend on the ability of banks to satisfy those needs.

BRIAN SULLIVAN: We'll now fast forward these years later, and the agency you now lead is 87 years old. And it's been around since 1933 to essentially make sure that our banks function in this country through good times and in bad. I know you don't have a crystal ball, but early indications are the banks are weathering this.

JELENA MCWILLIAMS: I ordered one on Amazon. It just - it's been delayed in shipping. [laughs].

BRIAN SULLIVAN: Well, will it be able to forecast for you how the banks might be weathering this storm in the coming months?

JELENA MCWILLIAMS: I'm afraid the crystal ball won't be able to tell me. Here's what we're looking at. We know that usually in the economic recovery, it takes several quarters for the banks to feel the real effect of the economic shock. So we're looking forward and trying to understand exactly where are going to be the biggest exposures that banks have, given the economic shutdowns and a slow reopening of the economic activity in different states. We're looking specifically at agricultural lending. We're looking at small business lending, as well as the exposures that banks have to industries that have been particularly hit hard.

BRIAN SULLIVAN: Commercial real estate?

JELENA MCWILLIAMS: Commercial real estate, tourism, restaurants, airline industries, hospitality. Any one of those industries is going to take some time recovering, because people are not able to frequent restaurants. They're not able to travel. They're not flying. They're barely flying. And we have heard about the airlines laying off and furloughing a significant percentage of their workforce.

So, we're looking at the exposures banks have in those particular industries. But in the end, it's an ecosystem. And one thing pulls the other. They're dependent and codependent in many cases. And so, when you see furloughs and layoffs in any industry, you have to expect that there will be some exposure to banks, to those individuals, because those individuals will no longer be able to make their monthly payments, whether on credit cards, auto loans, rent, mortgages, whatever credit they may have.

So, we are monitoring conditions very carefully to make sure we understand what's coming down the pike, and if at all possible, to preempt it on the regulatory side so that banks can remain viable, they can remain safe and sound, and ensure there's enough consumer protection while they're able to aid the economic recovery and provide for their communities.

BRIAN SULLIVAN: Now, we've been talking about banks as though they're a single organism out there, but really there are many different kinds of banks, but how ‘bout the smaller community-based banks, the Minority Depository Institutions, the minority-owned and managed banks out there.

JELENA MCWILLIAMS: They are, they are different. And I'll tell you why. Starting with community banks, they're usually much smaller in size than their larger brethren. And they function usually with one, two, three, maybe five, six branches. And geographically, they are narrowly located, meaning they're in one or two communities, quite often in just a single state. We also have banks that have a single branch that have been in existence for a while, and they don't plan to open up another branch.

And so, the impact on those institutions, because they're not highly diversified, is going to be even more significant, because usually they're located in rural areas where there is one or two employers. And if those employers start laying people off because of the lack of the economic activity, those banks will be even more so impacted depending on the diversification of their balance sheets.

With respect to the Minority Depository Institutions…those are institutions that are generally owned by minority personnel or shareholders and managed by a minority director or a board or executive team…frankly, those institutions are going to be in some cases, particularly hard hit.

When we think about the African American community, the Minority Depository Institutions, or so-called MDIs that exist in those communities, they generally get low deposit amounts in their checking accounts. Because of the economic conditions, it's going to be even more difficult for those banks to maintain those accounts and make sure that their borrowers have adequate means to satisfy the monthly payments or to have the credit.

At the FDIC we have made specific emphasis on MDIs, and particularly on African American MDIs, to make sure that they can survive and continue to prosper. Because frankly, the number of African American MDIs in the country has been shrinking, and we would like to reverse that trend. We would like for those communities to thrive, and we would like for the African American banks, in particular, to be able to continue to function in their communities and provide responsible credit and financial services.

BRIAN SULLIVAN: Indeed, the number of FDIC-insured institutions have declined in the past 20 years. And is that a sign of health in the banking world? Or is it a harbinger of bad things?

JELENA MCWILLIAMS: It's not a harbinger of bad things. Depends how you look at it. Generally, there's consolidation in the banking sector because smaller banks simply do not have the economies of scale to be able to partake in the bigger economy at a scale they need to be able to spread the cost on multiple units of products and services. And so, they find the compliance burden and the money they have to invest in new products, technology, complying with Anti-Money Laundering and Bank Secrecy Act regulations, for example, they find them prohibitively expensive.

So, then they look for a buyer, or they become a target for a buyer in the local community usually, or somebody who's looking to expand in that geographic community. And so, we have seen a serious decline, especially among the community banks…while the three or four largest banks are getting bigger and bigger, we have seen consolidation in the community banking sector where, in a healthy year, we have about 200 mergers.

So, when you think about it…my term is five years in the office, that was my appointment as the chairman of the FDIC…so, from the moment when I walk into this office, until I walk out, in those five years, we're going to look at probably 1,000 fewer community banks.

When I walked in, we had about 5,600. We are now at about 5,100. We just had about 57 mergers in the first quarter of this year. And we're looking at a decline that frankly is very fast. I would say in some communities, shocking, because to the extent that the new bank, that the acquiring bank, remains open in that community, that's great. But to the extent that they start closing down branches, that becomes a problem for the community, especially if they only have two, three branches of different banks in the entire community.

So, we're looking at the consolidation in the banking sector, and specifically with respect to the community banks, trying to figure out, is there anything we can do on the regulatory side to enable these banks to survive and persevere and continue to serve their communities?

BRIAN SULLIVAN: And what is the forecast for bank failures? Back in the last economic crisis, we saw a lot of those. And it's a rare event now, but is FDIC well positioned to manage what might happen?

JELENA MCWILLIAMS: The FDIC is absolutely well positioned to manage. The Deposit Insurance Fund is at a record high of over $113 billion.

BRIAN SULLIVAN: Now what does that mean for most people out there?

JELENA MCWILLIAMS: So the Deposit Insurance Fund is a fund where banks pay premiums, so an insurance pool where every bank that is supervised by the FDIC for the deposit insurance and insured by the FDIC, will pay premiums based on the total amount of assets they have at the bank itself. We have a formula for large banks. We have a formula for small banks. And based on that formula, they will enter different variables. And we will tell them how much they need to pay to pre-fund the Deposit Insurance Fund for the failures that may come down the road.

So, we saw in 2009 that the Deposit Insurance Fund went negative. We were in the red. Why? Because we had a few large failures that basically wiped out, then, what was available in the Deposit Insurance Fund. And so, we do not want to have the repeat of that. So, we have been beefing up the Deposit Insurance Fund. We are at a healthy level with the DIF at this point in time. And should we have some bank failures, we have certainly changed the way we function internally within the FDIC. We have consolidated our large bank supervision and resolution in one group. And we have done a number of different improvements to make sure that we are prepared. Having learned the lessons from 2008 and '09, we are prepared for bank resolutions should they come down the pike.

BRIAN SULLIVAN: And just to be clear, that fund is the fund that protects *people's* deposits?

JELENA MCWILLIAMS: Correct. That fund does not protect the bank itself. So, when we take the bank into receivership, basically the state authority, chartering authority will close down the bank. They will appoint us as the receiver. And the FDIC will step in and manage the remaining assets of the bank.

And so, the Deposit Insurance Fund serves to protect the depositors that are insured. And you can go to our website at fdic.gov. And there is a calculator to see how much is insured. Generally speaking, we insure up to $250,000 per account. To find out how you're protected and exactly to what amount you're protected if you have multiple accounts at the bank, you're welcome to use one of our calculators we have on the website.

BRIAN SULLIVAN: And as FDIC is so proud of saying, how much have depositors lost?

JELENA MCWILLIAMS: Oh, my favorite saying…no insured depositor has lost a penny of their deposit since 1933 when the FDIC was created.

BRIAN SULLIVAN: Madam Chairman, thank you so much for joining us.

JELENA MCWILLIAMS: Thank you. It was my pleasure.