FAQs - The Current Regulatory Environment and the Bank Term Funding Program - (March 2023*)

How have the recent bank failures impacted the regulatory environment?
Today there is increased focus by financial services leaders, compliance professionals, and regulators on issues related to:

- Risk tolerance
- Interest rate risk
- Asset liability management
- Liquidity

What are financial services institutions doing now from a compliance training standpoint to address current conditions?
Many depository institutions are implementing employee training plans focused on:

- Protecting deposits
- Clarifying FDIC insurance guidelines
- Handling depositor concerns

Some organizations are also training additional people in loan review. For many financial services institutions, their loan portfolio is their largest asset and principal source of revenue. The loan portfolio is also one of the larger sources of risk to these institutions' fiscal soundness. Specifically the training of interest includes the following topics:

- Credit risk ratings
- Enterprise risk management
- Underwriting quality
- Current Expected Credit Losses (CECL)
- Repayment and collateral considerations
- Portfolio management
- Managing and resolving problem loans

What are financial services institutions doing now from a policies and procedures standpoint to address current conditions?
One of the primary ways regulators expect boards of directors and leadership to exercise their fiscal responsibility is with policies and procedures. Board-approved policies and procedures set the tone for the organization's risk tolerance and demonstrate the support for compliance expected of all employees in their daily activities.

Today, many board members and executives are also reviewing their policies and procedures related to risk tolerance, interest rate risk, asset liability management, and liquidity and making adjustments where appropriate. Specifically, they are looking at policies like the following:

Model Risk Management Program Policy
This policy governs the organization's use of qualitative analysis and models of decision-making on a broad range of risk-related activities in a consistent manner. Key issues to consider with this policy include providing a framework for:

- Failure to assess potential exposure to financial loss
- Poor business and strategic decision-making
- Miscommunication and damage to the institution’s reputation
- Failure to validate or modify assumptions used for models
- Development of processes to handle escalating issues
- Tracking and prioritizing model issues
- Deficiencies identified internally or by an outside party

The Current Expected Credit Losses (CECL) Policy
This policy covers the organization’s use of the CECL methodology for estimating credit loss allowances. CECL is a credit loss accounting standard (model) issued by the Financial Accounting Standards Board (FASB) that allows for timely adjustment of reserve levels based on reasonable expectation of future conditions. Key issues to consider with this policy include:

- Ensuring monitoring and reporting procedures are consistent with the CECL model
- Whether reserve adjustment procedures can be timely

The Stress Testing Policy
Financial stress tests assess whether an organization is sufficiently capitalized to absorb losses during stressful conditions while meeting obligations to creditors and counter-parties and continuing to be able to lend to households and businesses.

The Dodd-Frank Act requires certain financial companies with total consolidated assets of more than $250 billion, and regulated by a primary federal financial regulatory agency, to conduct periodic stress tests. Smaller financial institutions may also want to consider evaluating how their organization is prepared for likely economic or regulatory changes. Key issues to consider with this policy include:

- Capitalization compared to other similar organizations
- The organization’s risk profile as defined by the regulators
- The timeliness and relevancy of the stress scenarios used in evaluating the organization
- The ability of the organization to move from the non-stress regulatory capital requirements to a stress-test-based capital requirements if needed

Specifically, some organizations are also revisiting their loan review processes to ensure they are in line with loan review best practices and organizational risk tolerances.

What is the Bank Term Funding Program (BTFP)?
According to the Federal Reserve, the BTFP was created to support American businesses and households by making additional funding available to eligible depository institutions. This would help ensure banks can meet the needs of all their depositors. The BTFP offers loans of up to one year in length to banks, savings associations, credit unions, and other eligible depository institutions pledging any collateral eligible for purchase by the Federal Reserve Banks in open market operations (see 12 CFR 201.108(b)), such as U.S. Treasuries, U.S. agency securities, and U.S. agency mortgage-backed securities. These assets will be valued at par. The BTFP will be an additional source of liquidity against high-quality securities, eliminating an institution’s need to quickly sell those securities in times of stress.

What does the BTFP mean for other regional and small-sized U.S.-based financial services organizations?
If market conditions continue to present liquidity problems for financial institutions, the Federal Reserve's BTFP is designed to increase liquidity for financial institutions in need. For more information on the Federal Reserve's BTFP see https://www.federalreserve.gov/monetarypolicy/files/bank-term-funding-program-faqs.pdf.

*BAI will continue to provide updates on regulatory changes as they occur. If you have any questions on the regulations or compliance training implications, please contact expertopinion@bai.org.