COVID-19: ITS IMPACT ON BANKING, FINTECH, AND PAYMENTS: FAQS

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1. Q. THE CORONAVIRUS AID, RELIEF, AND ECONOMIC SECURITY ACT ("CARES ACT") IMPLEMENTS THE DISBURSEMENT OF $1,200 PAYMENTS OF COVID-19 STIMULUS FUNDS TO MILLIONS OF AMERICANS. HOW WILL THE CURRENT PAYMENT SYSTEM ADDRESS THE LOGISTICAL ISSUES INHERENT WITH THE DISTRIBUTION OF SO MANY PAYMENTS?

A. The distribution of these stimulus checks will have a huge impact on the payments industry, as it will highlight the need for electronic payments over paper checks. Never before has there been such an immense need to push funds to so many Americans at the same time. We currently understand that the Internal Revenue Service ("IRS") plans to distribute funds via the same direct-deposit mechanism used for payment of tax refunds. However: (a) is its direct deposit information up to date, and (b) will there be sufficient fraud-prevention measures in place? Most importantly, what about the recipients whom the IRS does not have bank account information? Ideally, the government should consider some of the newer digital payment platforms that allow for "push payments" to recipients who can choose their preferred method for receiving funds. New technologies allow for faster and more secure ID verification and fraud-prevention measures. With COVID-19, more consumers are moving to mobile apps and online platforms and will be seeking faster online payment solutions. A recent Forbes article notes that in Europe, the virus has already driven a 72 percent rise in the use of fintech apps[1]. Given the timing, U.S. government agencies should view fintechs as an effective part of the solution in the payment distribution process.

2. Q. HOW DO BANKS AND OTHER LENDERS GET INTO THE CARES ACT SBA LOAN PROGRAM AS A SMALL BUSINESS ADMINISTRATION ("SBA") SECTION 7(A) LENDER? WHAT IS THE PROCESS, AND HOW LONG WILL IT TAKE?

A. The existing process to become an SBA Section 7(a) lender differs significantly depending on whether the applicant is a federally regulated financial institution (bank or credit union) or a nondepository, state-regulated small business lender (called Non-Federally Regulated Lenders ("NFRLs") under the SBA's rules). Until now, these are the only types of entities eligible to apply to become a Section 7(a) lender. For banks and credit unions, the application process is fairly simple. NFRLs, on the other hand, are required to submit extensive information as part of an application.

The CARES Act allows for additional lenders determined by the SBA and the U.S. Treasury ("Treasury") to become a Section 7(a) lender. We do not yet know what eligibility or application requirements the SBA and

Treasury will impose. The SBA might apply some of the existing application requirements for NFRLs, but if the objective is to onboard lots of new lenders quickly, it seems that some of those extensive requirements may be relaxed for new lenders. We understand that the SBA website will be open for applications as soon as Friday, April 3.

3. Q. WILL THERE BE ENHANCED BANK REGULATORY SCRUTINY OF BANK-FINTECH PARTNERSHIPS? HOW SHOULD BANKS BE MONITORING THE FINANCIAL HEALTH OF THEIR FINTECH PARTNERS?

A. Bank regulators have become increasingly supportive, and even encouraging, of bank-fintech partnerships. That is unlikely to change on account of COVID-19. Regulators view bank-fintech partnerships through the prism of vendor risk management. Banks that have partnered with a fintech company, particularly one that provides a critical product or service to the bank or its customers, are likely to experience increased regulatory scrutiny of the bank's vendor risk management policies, procedures, systems, and controls relating to the fintech partnership. Especially in the context of an economic downturn, regulators will expect banks to monitor the financial condition of their fintech partners to ensure that the fintech partner has sufficient resources to perform its obligations to the bank. Banks should review their contracts with their fintech partners to determine whether they provide for adequate disclosure and reporting of the fintech partner's financial information, including information regarding its financing plans. Banks that have partnered with start-up or other less-established fintech companies are expected to have appropriate contingency plans in case the fintech partner experiences a business interruption, fails, or declares bankruptcy and is unable to perform its obligations to the bank.

4. Q. ARE WE LIKELY TO SEE AN UPTICK IN BANKS INVESTING IN THEIR FINTECH PARTNERS? WHAT ARE SOME OF THE KEY LEGAL AND REGULATORY CONSIDERATIONS FOR SUCH INVESTMENTS?

A. Many fintech companies are funded with venture capital. If the COVID-19 pandemic makes it more difficult for early stage companies to raise venture capital, fintech companies in the banking area may increasingly turn to their bank partners for financing. Banks are generally permitted to make investments in companies that are engaged in activities that would be legally permissible for the bank to engage in itself. A bank that makes a direct investment in a fintech company should consider imposing contractual obligations that limit the fintech company's activities to permissible banking activities and that allow the bank to withdraw its investment in the event that the fintech company's activities become impermissible. Banks with a holding company parent may consider making a noncontrolling investment through the holding company, which would permit an investment in a fintech company that may be engaged in activities that would not be permissible for the bank to engage in itself. The Board of Governors of the Federal Reserve System recently issued a final rule that clarifies what it means for a bank or its holding company's investment to be noncontrolling. In all cases, a fintech company receiving investment funds from a bank or its holding company should understand the regulatory consequences of the investment, in particular, whether it will subject the fintech company to supervision and examination by its bank partner's regulator.

5. Q. WILL THE BANK REGULATORS ALLOW THE BANKS FLEXIBILITY IN DEALING WITH THEIR BORROWERS WHO ARE AFFECTED BY COVID19? DO ACCOMMODATIONS RESULT IN LOANS HAVING TO BE REPORTED AS DELINQUENT, TROUBLED DEBT RESTRUCTURINGS (“TDR”S), OR OTHER NEGATIVE CONSEQUENCES? AND WHAT ABOUT STATE MONEY TRANSMITTER REGULATORS—WILL THEY BE WILLING TO PROVIDE FLEXIBILITY TO THEIR LICENSEES?

A. Banks and their regulators learned much responding to consumer loan defaults during the 2008 Great Recession. Those lessons have made banks and bank regulation stronger, more resilient and better able to deal with the likelihood of widespread consumer default. But commercial real estate and purely commercial lending may be a different story. Some large commercial borrowers have drawn down lines of credit to assure adequate cash flow. Delinquencies in commercial real estate loans are presently low, but will increase as tenants of commercial borrowers are unable to pay their rent. Declines in collateral values caused by a lengthy COVID19 inspired shutdown of the economy are likely to increase and become apparent by the time banks file their second quarter call reports at the end of July.

Despite these risks, the federal bank regulators are being understanding in this crisis. They have taken the position that financial institutions may accommodate their borrowers who are affected in a variety of ways by the COVID19. Financial institutions may allow for skipped payments for a period of time. If this results in extending the original maturity or creating a balloon payment at the end of the loan, financial institutions are encouraged to provide disclosure to the borrower of the changed terms and the effect. When loan accommodations are made, they do not necessarily result in the loan being reported as past due or delinquent. If the borrower was current when the accommodation is made, the loan would not generally be required to be reported as delinquent. Moreover, modifications of loan terms also do not automatically result in classification of the loan as a troubled debt restructuring (TDRs) because the federal bank regulators have confirmed with the Financial Accounting Standards Board (FASB) that a short-term (e.g. 6 months) modification made in good faith in response to COVID19 to borrowers who were current prior to the relief is not a TDR. For real estate related transactions, the federal bank regulators have taken the position that there is no need to obtain updated valuation information when granting the short-term loan modification.

At the state level, Nationwide Multistate Licensing System (“NMLS”) has encouraged state regulators that oversee money transmitter licensees to be flexible and lenient on certain obligations imposed on their licensees. For example, for MSB call reports that would otherwise be due on March 31, NMLS has encouraged regulators not to take administrative action against a licensee if the report is filed within 30 days of the due date.

6. Q. HOW WILL COVID-19 IMPACT CONSUMER BANKING? WILL THIS CHANGE SIGNIFICANTLY CONSUMER BEHAVIOR WITH RESPECT TO BRANCH BANKING?

A. COVID-19 has profoundly impacted our way of life in multiple ways, including how we interact with the banking system. Disruptions to consumer banking have already started to emerge. The short-term impact of COVID-19 to date has not presented systemic problems for the consumer banking sector. Banks have sufficient liquidity and financial strength. While COVID-19 has prompted many to limit services to drive-up and automated teller machine transactions, customers understand the restrictions are caused by a threat to public health, not concerns over the stability of their bank. There are no lines of anxious customers out the door seeking to make withdrawals.

In addition, Federal Deposit Insurance Corporation ("FDIC") insurance has assured a stable U.S. banking system since 1934. The CARES Act authorizes the FDIC to re-implement the transaction account guarantee program providing unlimited insurance for deposits in noninterest-bearing checking accounts through December 31, 2020. The strategic issue for community-based financial institutions is how to maintain their relevance to the customer base. In an industry whose traditional hallmarks have been trust and local community ties, how do they survive in a world looking for convenience and scale? COVID-19 only exacerbates the speed with which community-based financial institutions must face this issue. Consumers want all the conveniences provided by technology yet continue to yearn for the security and sense of community and trust they get from the brick-and-mortar branch. Where this ends will continue to be a work in progress.

7. Q. WHAT DISRUPTIONS TO THE BANKING SYSTEM ARE ANTICIPATED AS A RESULT OF THE COVID-19 SITUATION?

A. Pre-COVID-19 declines in interest rates had spurred a significant increase in mortgage refinancing applications. The ability of banks to process those applications has been impeded by COVID-19, as bank lending personnel have been limited to working remotely and necessary governmental functions provided by recording offices and municipalities have been suspended. But make no mistake about it, this may be only the calm before the storm. Millions of consumers are facing job loss. Delinquencies of existing loans are expected to spike. A potential wave of new credit applications from out-of-work consumers without liquid resources could overwhelm the system. Regulators to date have been proactive. They have encouraged banks to adopt reasonable forbearance policies, delayed the phase-in of Currently Expected Credit Losses standards, and temporarily relaxed the community bank leverage ratio and rules requiring banks to report loan modifications during the crisis as TDRs.

The longer term and strategic implications of COVID-19 on banks are of greater concern. The deposit side of the consumer banking business has been under increasing strain from declining net interest margins and competition from shadow banks, fintech competitors, and large banks with top-of-mind technology and data collection advantages for a number of years. The fallout from COVID-19 is only likely to cause that strain to increase at a faster pace. Millennial customers want real-time payments and convenience-based products such as online banking, mobile banking, and remote deposit capture. They do not want to set foot in a bank branch. The worldwide fear of contracting a deadly virus from casual, everyday contact will only make those customers prefer mobile banking and other remote payment channels where contact with third parties is not needed to effect a banking transaction. A consumer banking system based upon strong but impersonal technology has obvious benefits. However, it also will have vulnerabilities from cybersecurity threats and third-party actors and disrupt the important role community banks have traditionally played.

8. Q. WHAT HAPPENS WHEN CORE VENDOR SERVICES AND TECHNOLOGY ISSUES ARE IMPACTED FOR EVEN A SHORT PERIOD OF TIME? HOW CAN PARTIES ADDRESS "TEMPORARY CHANGES" IN COMMERCIAL CONTRACT

TERMS OR CONSUMER TERMS AND CONDITIONS TO RESPOND TO COVID-19 ORDERS OR GUIDANCE?

A: Since there can be a significant impact on services being provided, it is important to be familiar with your business continuity plan, especially when many employees may be working remotely, which may not have been fully contemplated in your existing plan. If you are able to work with your service provider or recipient to modify existing commercial terms in light of the COVID-19 impact or its potential impact, then such modifications or changes should be documented in writing and agreed to by an authorized representative of each party. For temporary modifications to consumer terms due to state and local COVID-19 orders, clear disclosures at the consumer access point (e.g., website) are recommended, especially where the method of notice under the consumer terms would not provide timely notice. Additional notifications or disclosures may be required depending on the consumer terms, which should also be complied with.

9. Q. HOW SOON SHOULD YOU PROVIDE NOTICES OF FORCE MAJEURE EVENTS TO YOUR CUSTOMERS AND CLIENTS? CAN PARTIES PROACTIVELY WORK TOGETHER TO AVOID A FORCE MAJEURE EVENT OR ANTICIPATED BREACH OF SERVICE-LEVEL AGREEMENTS?

A: A force majeure clause is a provision of a contract that excuses a party from performance if an extraordinary event prevents one or both parties from performing their obligations. If your contract contains such a clause, the particular wording, along with other contractual provisions, will be important in determining whether the clause applies and any resulting obligations you may have. For example, you will need to determine whether the COVID-19 falls within any of the specific triggering events in your force majeure provision or whether there is an opening clause or catch-all provision that may encompass it. It will also be important to determine what impact the triggering event has on your obligations under the contract. Does the clause require that performance be made “illegal or impossible,” or is it just that performance be “impractical” or “commercially unreasonable”?

If the force majeure clause is triggered and applicable, there are often notice provisions. For example, many contracts require notice within 10 days of learning of the triggering event. Other contracts may have notice provisions that require notice “as soon as possible,” while others may contain no notice provision at all. You will need to consider what the triggering event for notice will be. It might be the declaration of a pandemic, the presence of a state of emergency, a government ban in a particular location, or a myriad of other events. In general, we recommend that you be proactive in notifying and working with customers or clients if you foresee a potential problem performing under the contract. Parties are able to work together proactively to possibly avoid a contractual default. For example, consider whether there are alternative methods of performance, delayed or postponed performance, or other ways to mitigate damages. Moreover, the parties to a contract are free to renegotiate its terms by agreement.

10. Q: WHAT HAPPENS WITH PROCESSING OR BANK SPONSORSHIP AGREEMENTS THAT RELY ON VOLUME-BASED PRICING? IF THE VOLUME OF TRANSACTIONS PLUMMET, WILL THERE BE A WAVE OF TERMINATIONS? IF THE PROGRAM MANAGERS CANNOT MAKE PAYMENT OF THEIR MINIMUMS, WHAT IS THE IMPACT ON SMALLER SPONSORING BANKS?

A: Agreements that rely on minimum volumes to calculate fees should be reviewed as soon as possible to assess the consequences of a sharp decline in transaction volume. Whether you are the entity paying or receiving such fees, the economic consequences of a downturn in transactions due to COVID-19 will likely have a direct impact. As noted in FAQ 8 above, certainly one should review any force majeure language in the agreement and assess the enforceability of the language. Parties to such agreements should consider various options, including (a) termination rights, (b) the ability to temporarily suspend performance, and (c) short-term amendments to the agreement. Depending on the status of the agreement and the relationship of the parties, rather than viewing the situation as an adversarial event, a party may wish to open up communications with the counterparty in an effort to seek a win-win solution, to the extent one is possible.

11. Q: DOES COVID-19 FINALLY USHER IN THE DEMISE OF PAPER CHECKS IN THE UNITED STATES?

A: There are many who think that it may. The United States is the last major industrial country to rely heavily on check payments. A change in habit is hard, but COVID-19 is already forcing such changes. As the Forbes article in FAQ 1 noted, COVID-19 has already triggered a sharp increase in the use of mobile and online applications in Europe. Similarly, online payments are expected to grown in the US, as consumers experience the speed and convenience of new applications.

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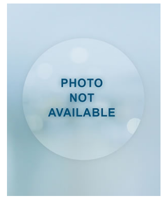

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