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INSIGHT

COVID-19 Impact on the Banking Industry: Conditions at the End of 2020

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Although bank regulation is designed to allow banks to withstand some amount of unexpected losses, the economic ramifications of the Coronavirus Disease 2019 (COVID-19) pandemic could result in enough borrowers missing loan payments to cause distress for banks. The Federal Deposit Insurance Corporation (FDIC) releases comprehensive data on bank condition and income quarterly, and it recently released the *Quarterly Banking Profile: Fourth Quarter 2020*, which reports aggregate data from all 5,001 FDIC-insured institutions as of December 31, 2020. This Insight presents certain bank industry statistics as of the end of 2020 and examines how the pandemic might be affecting the industry.

Background

Economic downturns threaten bank profitability, reduce bank income, and impose losses as borrowers miss repayments. Meanwhile, bank liabilities—the deposits they hold and the debt they owe—obligate banks to make funds available to depositors and creditors. If borrower repayments decline enough, a bank's ability to meet its obligations could become impaired, potentially causing it to fail. In contrast, bank capital—largely equity stock and retained profits from earlier periods—enables a bank to absorb a certain amount of losses without failing. For this reason, bank regulators require banks to hold certain amounts of capital (in addition to subjecting them to a variety of safety and soundness regulations) in order to avoid failures. However, if losses are sufficiently large, banks may nevertheless fail, reducing credit available to the economy and potentially destabilizing the financial system.

Certain effects of, and bank responses to, economic downturns—such as reduced income and increased credit loss reserves—occur shortly after the onset of economic deterioration. Other effects—such as increased loan delinquency, incurred losses, and reduced capital value—occur after a longer lag (see CRS Insight IN11501, *COVID-19 Impact on the Banking Industry: Lag Between Recession and Bank Distress*). Thus far, the bank industry appears to be holding up well, but as the pandemic continues to affect the economy, signs of stress may start to emerge.

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Income and Loss Reserves

Full-year 2020 profit for the banking industry was $147.9 billion, a 36.5% decrease from 2019 (see **Table 1.**). The full-year decline came mostly from banks increasing credit loss reserves in the first half of the year—possibly in response to the pandemic's effects on the economy—accounting for $132.2 billion in expenses in 2020, a 140% increase from 2019. In addition, net interest income declined by $20.0 billion (or 3.7%) as the average net interest margin (the difference between the interest rates banks earn and pay out) declined to 2.82% from 3.36%.

Credit loss reserves adjust income on loans and other assets by accounting for potential future losses on those loans and assets. In June 2016, the Financial Accounting Standards Board promulgated a new credit loss standard—Current Expected Credit Loss (CECL)—which requires earlier recognition of losses. Large publicly traded companies (including publicly traded banks) were required to issue financial statements that incorporated CECL for reporting periods beginning December 15, 2019. Although the CARES Act (P.L. 116-136) mandated that regulators cannot require banks to use CECL until the earlier of the end of the public health emergency or the end of 2020 (and the bank regulators gave banks the option to delay the use of CECL for two years followed by a three-year transition period), 279 banks nevertheless made the transition by the fourth quarter. Reportedly, most of the largest banks that collectively hold nearly 80% of the industry's assets are among those that made the transition. This makes it difficult to determine to what extent the recent changes in loss reserve statistics are the result of the pandemic. For more information on CECL, see CRS Report R45339, *Banking: Current Expected Credit Loss (CECL)*.

Table 1. Bank Income and Credit Loss Reserve Expenses

	2020	2019	Annual change
Net income	$147.9 billion	$233.1 billion	-36.5%
Credit loss reserve expenses	$132.2 billion	$55.1 billion	140.0%

Source: FDIC, *Quarterly Banking Profile: Fourth Quarter 2020*.

Loan Performance and Capital

Loan performance and capital levels—two indicators that deteriorate after a time lag—have yet to be significantly affected by the pandemic.

The noncurrent loan rate (i.e., percent of loans more than 90 days past due or in nonaccrual status) rose during the year, although the level is not unusually high. However, as part of an exception allowed under the CARES Act, banks are not yet reporting loans that are in forbearance as noncurrent. The fourth quarter noncurrent rate was 1.18%, up from 0.91% a year earlier (see **Table 1.**). For context, after the 2007-2009 financial crisis, the rate peaked at 5.46% in the first quarter of 2010.

Loan *charge-offs* (when a bank gives up on a loan and writes off the loan's reported value from its assets) ticked down from the third quarter and a year ago. The net charge-off rate was 0.41%, down from 0.54% a year earlier. The post-financial crisis rate peaked at 3.00% in the fourth quarter of 2009.

Banks added $41.9 billion in bank equity capital in the fourth quarter of 2020, a 1.9% quarterly increase, up from a year ago when banks added $12.8 billion, a 0.6% quarterly increase. (In the last crisis, bank equity capital decreased by $44.9 billion, or 3.3%, in the third quarter of 2008.) The increase in capital was almost entirely due to retained earnings—that is, profits that were not distributed to shareholders as dividends—which were 571% greater in the fourth quarter than a year earlier. This may be due, at least in part, to regulator limits on capital distributions imposed during the pandemic. It may also indicate that banks are building up their capital reserves to be flexible to respond to future adverse conditions.

Table 2. Loan Performance and Capital

	4th quarter 2020	3rd quarter 2020	4th quarter 2019
Noncurrent rate	1.18%	1.17%	0.91%
Net charge-off rate	0.41%	0.46%	0.54%
Bank equity capital (BEC)	$2,225 billion	$2,183 billion	$2,111 billion
BEC quarterly change	$41.9 billion, or 1.9%	$36.3 billion, or 1.7%	$12.8 billion, or 0.6%

Source: FDIC, *Quarterly Banking Profile: Fourth Quarter 2020*.

The number of banks on the FDIC's "Problem Bank" list may also indicate the industry has yet to experience widespread stress, as that number rose slightly during the year to 56 at the end of 2020 from 51 at the end of 2019.

Author Information

David W. Perkins
Specialist in Macroeconomic Policy

Raj Gnanarajah
Analyst in Financial Economics

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