"Life is what happens to you while you're busy making other plans."

- John Lennon, co-founder of 'The Beatles,' was born on this day in 1940

In this Issue...

- Community Bank Optimism on Local Economic Health Ticks Up Slightly but Concerns Remain
- 2020 Hindsight is Uncertainty
- CSBS Comment Letter: Qualified Mortgage Definition Under the Truth in Lending Act: Seasoned QM Loan Definition

Community Bank Optimism on Local Economic Health Ticks Up Slightly but Concerns Remain

Community bankers are feeling slightly better about the health of their local economies but still far short of their pre-pandemic level of confidence, the most recent Community Bank Sentiment Index (CBSI) reveals.

The Conference of State Bank Supervisors publicly released the third quarter results this week, collecting data from 334 community banks across the nation during the month of September. The results showed a sentiment index of 97 points, up from 90 in the second quarter. Prior to the pandemic, the sentiment index hovered in the low 120s.
The CBSI captures on a quarterly basis what community bankers nationwide think about the future. Participant answers are analyzed and compiled into a single number; an index reading of 100 indicates a neutral sentiment. Anything above 100 indicates a positive sentiment, and anything below 100 indicates a negative sentiment.

Key findings from the third quarter 2020 results include:

- The regulatory burden component is at 57, the same as for Q2, and again at a record low.
- Regulatory burden drove the uncertainty category to its highest at 44 points, up from 32 in 2Q.
- Bankers reported an improved outlook in business conditions, up to 103 points from 93 in the last quarter, and franchise value, up to 116 points from 98 in the same period.
- Their profitability outlook remains a concern, despite showing a 13-point increase to a value of 68 in the third quarter.

“The slight increase of community bankers’ overall optimism is notable; however, the fallout of the pandemic continues to create uncertainty for local communities,” said CSBS President and CEO John Ryan. “Policymakers should note their concern about future profitability and regulatory burden.”

2020 Hindsight is Uncertainty

By CSBS Senior Economist and Director of Research Thomas F. Siems, Ph.D.

If the old expression “hindsight is 20/20” is true, then as we look back on this year of the pandemic/lockdown, uncertainty is sure to be an overriding theme. And community
bankers would seem to agree. Their responses to CSBS’s third quarter 2020 survey used to compute the CBSI express more uncertainty now than ever before.

As shown in the nearby chart, the overall level of community banker uncertainty leapt in the third quarter by 12 points to an index of 44, a rating that is even higher than the assessment of 42 recorded in the first quarter 2020 survey. The “uncertainty index” is calculated by summing the percent of “Don’t Know/Not Sure” responses for each of the seven questions that makeup the CBSI.

So, what are bankers in angst about the most?

A deeper dive into bankers’ “uncertainty” reactions to each CBSI survey question can provide some clues. The chart below shows that the upsurge in the third quarter 2020 uncertainty index is driven primarily by an increase in regulatory burden uncertainty (green bars). The regulatory burden uncertainty index spiked to 13 in the third quarter
Indeed, the table below compares the uncertainty indices for all seven CBSI components for the second and third quarters of 2020. The components with the greatest levels of uncertainty in the third quarter 2020 are Regulatory Burden (13), Monetary Policy (12) and Business Conditions (9). With a sum of 34 points, these three components comprise 77% of the total (44).

**Uncertainty Values for CBSI Component**

<table>
<thead>
<tr>
<th>CBSI Component</th>
<th>Q2 2020</th>
<th>Q3 2020</th>
<th>Change</th>
</tr>
</thead>
<tbody>
<tr>
<td>Regulatory Burden</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Monetary Policy</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Business Conditions</td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

2020 from levels of between 1 to 4 for previous surveys.
<table>
<thead>
<tr>
<th>Category</th>
<th>Q1</th>
<th>Q2</th>
<th>Q3</th>
</tr>
</thead>
<tbody>
<tr>
<td>Business Conditions</td>
<td>7</td>
<td>9</td>
<td>2</td>
</tr>
<tr>
<td>Monetary Policy</td>
<td>12</td>
<td>12</td>
<td>0</td>
</tr>
<tr>
<td>Regulatory Burden</td>
<td>2</td>
<td>13</td>
<td>11</td>
</tr>
<tr>
<td>Operations Expansion</td>
<td>4</td>
<td>3</td>
<td>-1</td>
</tr>
<tr>
<td>Capital Spending</td>
<td>1</td>
<td>1</td>
<td>0</td>
</tr>
<tr>
<td>Profitability</td>
<td>3</td>
<td>2</td>
<td>-1</td>
</tr>
<tr>
<td>Franchise Value</td>
<td>3</td>
<td>4</td>
<td>1</td>
</tr>
<tr>
<td>CBSI</td>
<td>32</td>
<td>44</td>
<td>12</td>
</tr>
</tbody>
</table>

But perhaps more importantly, since the second quarter, uncertainty in Regulatory Burden has been the driving force behind this recent historic high level of uncertainty, covering 11 points out of the total quarterly increase of 12 points. Bankers are clearly concerned that regulators will use a heavier hand in evaluating the safety and soundness of their banks as they work through an expected increase in problem loans and a more
difficult financial environment.

Moreover, the overall outlook regarding regulatory burden for community bankers is dismal. The Regulatory Burden component for the third quarter 2020 is 57, the same as it was in the second quarter 2020, and the lowest value of the seven factors that comprise the CBSI.

In the third quarter 2020, 45% of community bankers expect regulatory burden to be heavier, 2% expect it to be lighter, 40% said it would remain the same, and the remaining 13% were unsure. Interestingly, community bankers who expect a heavier regulatory burden had an overall CBSI of 85, whereas the others had a CBSI of 106, where 100 is the neutral level. Bankers expecting a harsher regulatory environment also expect future business conditions, profitability, and monetary policy to be significantly worse than their peers who do not expect a more burdensome regulatory environment.

And community bankers are not alone. The chart below shows that U.S. economic policy
uncertainty has risen to unprecedented levels in 2020. This index is constructed from three underlying components: (1) news coverage about policy-related economic uncertainty, (2) federal tax code provisions set to expire and (3) the dispersion of disagreement among professional economic forecasts. The scholars who created this index have found a significant dynamic relationship exists between their index and real macroeconomic variables. A sustained increase in their economic policy index tends to foreshadow a decline in future economic growth. The good news is that this measure has generally declined from its peak in May 2020. However, it is still running well above past levels and continues to signal heightened uncertainty.
Most of us cannot wait for 2020 to be over. Following the announcement of the COVID-19 global pandemic and subsequent economic shutdown in March, all of us have had to deal with greater uncertainties in our homes, at work, how we buy and sell, how we interact with others, etc. Uncertainty is a major cause of stress and anxiety. Uncertainty proliferates with imperfect and unknown information. And uncertainty is the enemy of economic growth.

Even so, I am confident that we are past the worst of this crisis and that stronger economic growth and more jobs are in our future. And although community bankers have some concerns about how they will be handled by their regulators and how they will manage to maintain profitability during these difficult times, I am encouraged from this quarter’s survey that also shows that they plan to expand operations, increase capital spending, and foresee increases in franchise values as business conditions improve.

Community bankers, with their emphasis on developing and building relationships, are well positioned to help consumers and businesses in their local communities get through these times. And America will heal and be better as a result.

CSBS Comment Letter: Qualified Mortgage Definition Under the Truth in Lending Act: Seasoned QM Loan Definition

Last week, CSBS sent the following letter requesting that the CFPB provide additional time for comment on its proposed rule defining seasoned QM loans. This additional time will allow for more thorough consideration of the potential implications of the proposed rule for consumers, industry, and the mortgage market.

Dear Sir or Madam:
The Conference of State Bank Supervisors respectfully requests that the Bureau of Consumer Financial Protection (the “Bureau”) extend the deadline for the comment period on the Notice of Proposed Rulemaking titled “Qualified Mortgage Definition Under the Truth in Lending Act (Regulation Z): Seasoned QM Loan Definition” (the “proposed rule”).

State bank regulators charter and supervise 79 percent of all banks in the United States and also have licensing and supervisory authority over entities engaged in non-bank mortgage lending and servicing. State regulators are currently seeking to better assess how the proposed rule will impact the mortgage industry and consumers. CSBS feels that additional time for public input is needed to allow for thorough consideration of the implications of the proposed rule for consumers, the industry, and the mortgage market as well as to ensure thoughtful feedback is provided from a diverse group of stakeholders.

Within the past year, the Bureau has issued several proposed rules to amend its ‘Ability to Repay’ (ATR) standards and Qualified Mortgage rules which, like the proposed rule, will have significant implications for the mortgage market. Providing thoughtful input on the proposed rule, when considered in totality with these prior proposals, requires thorough analysis and robust deliberation by stakeholders.

In light of the potential significance of this proposal, in tandem with the Bureau’s other proposed QM/ATR changes, and its importance to state regulated entities, CSBS respectfully requests that the Bureau provide an extension of the deadline to submit comments on the proposed rule.

Sincerely,

John Ryan
President & CEO