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Financial impacts and disclosures for banking and capital markets (BCM)

The current landscape

There is limited precedent into how COVID-19 will impact the financial markets. Drawing on experience with past major events, including the credit crisis, it is important to be prepared for related financial results volatility and associated messaging to stakeholders as well as impact of regulatory actions and related disclosures.

Impacts will likely be felt across the reporting landscape

Financials

Market volatility and loss emergence will yield new risks and financial statement impacts that BCM institutions should plan for, analyze, and reflect in financial results

Disclosures

Financial statement users will expect BCM institutions to provide insight into COVID-19's impact on their business, investments, and loan portfolios in alignment with SEC materials for COVID-19-related disclosure

MD&A

Analysts will look for interest rate and credit risk sensitivity insights, both short- and medium-term outlooks for capital position, and clarity around significant estimates and assumptions

Controls

Virtual environments bring working complications to the performance of SOX controls that may require new controls to be implemented or processes re-tooled

COVID-19 financial impacts and BCM areas of focus

Legend: Low, Moderate, High

Focus area / challenge	F/S Risk	P&L Impact	B/S Impact	Considerations and response
CECL assumptions, reporting, and governance	High	High	High	• Assess the impact of the "Coronavirus Aid, Relief, and Economic Security Act (CARES Act)" on both CECL implementation and TDR considerations (see below section) • Consider banking agency guidance that certain short-term loan modifications in response to COVID-19 are not considered TDRs[1] • Evaluate how current CECL production results reflect COVID-19 impact (e.g., deteriorating economic conditions, changes in borrower behavior) and identify gaps in the process; assess ability to reflect impact within CECL model outputs • If rerunning models, refresh model assumptions (including current segmentation) and/or economic scenarios for current market conditions and potential prolonged economic recession • Determine whether a Q-Factor adjustment for COVID-19 can be substantiated or disclosed • Evaluate sufficiency of in-house capacity to cover urgent additional/iterative model runs (e.g., alternative scenarios, contemporaneous stress and liquidity testing for regulatory compliance) • Anticipate challenges inherent with the execution of first quarterly CECL run in production (i.e., first time SOX control execution in production and tactical considerations for CECL estimate governance in a virtual environment) • Anticipate regulatory and audit inquiries given first quarter post-adoption; prepare CECL summaries for communications to Audit Committee leading up to earnings and report releases
Regulatory and capital requirements	High	Moderate	Low	• Note that banks are encouraged to contact banking agencies if experiencing difficulty in meeting regulatory reporting requirements; relief decisions will take into account each bank's circumstances • Consider that working with borrowers of 1-to-4 family residential mortgages previously current are not considered restructured/modified for banking agencies' respective risk-based capital rules • Analyze debt covenants and potential violations; develop mitigation and communication plan • Preemptively discuss changes to terms or exemptions from lenders • Review regulatory capital and capital requirements models and calculations to validate for market irregularities and unexpected results in model output
Goodwill impairment	Moderate	Moderate	Moderate	• Evaluate whether the potential economic downturn (both in market and macroeconomic terms) constitutes a "triggering event" requiring a detailed assessment of intangible asset impairment, and choosing an appropriate triggering event date and reporting period (i.e., Q1, Q2) • Considerations in performing Step 0 qualitative or Step 1 quantitative impairment tests given uncertainty of situation but significant impact on market capitalization • Allow time pre-close for analysis and engage with relevant parties early to assess impacts
Hedging and risk management	High	High	Low	• Revisit accounting hedging relationships that were previously concluded to be "perfectly effective" given interest rate volatility (including impact on choose-your-rate debt), level of liquidity in the market, and impact on issuance of forecasted debt • Anticipate counterparty downgrades in hedge effectiveness reassessments (e.g., credit spreads, ratings, financial health, recent downgrades, liquidity, etc.) • Note that if a specific triggering event rendering the hedge ineffective can be identified, and if the entity concludes that hedging relationship was highly effective as of a date before a triggering event date, hedge accounting may be applied up to the date immediately before the trigger date
VIEs and equity method investments	Moderate	Low	High	• Reconsider existing VIE conclusions for any control/power implications in response to counterparties becoming insolvent or having liquidity constraints • Expect delays in receiving third party financial information in reporting exposure to loss for non-consolidated VIEs, especially those of smaller companies • Reassess ability to exercise significant influence over existing equity-method investees given uncertainty and risk of financial distress • Consider impairment implications for seed/minority investments in fintech companies
Valuation, FX	Moderate	Moderate	Moderate	• Revisit valuation/pricing processes, considering potential market displacement/liquidity events • Assess foreign currency risk impact for international operations and foreign assets/liabilities

SEC filing deadline relief and CARES Act

On March 25, 2020, the SEC issued an order **that gives public companies an additional 45 days to file certain disclosure reports that would otherwise have been due between March 1 and July 1, 2020,** if specified conditions are met. To use the relief allowed by the order, a registrant must file a current report on Form 8-K (or Form 6-K, as applicable) that discusses, among other things, (1) Why the issuer is "unable to meet a filing deadline due to circumstances related to COVID-19," (2) The estimated date by which the related filing will be made, and (3) If appropriate and material, a risk factor describing the impact of COVID-19 on the registrant's business.

The SEC will continue to monitor the impact of COVID-19 and may extend the time period for the relief if needed. Filers are advised to consider the guidance presented by the SEC Division of Corporation Finance communication dated March 25 regarding disclosure considerations pertaining to COVID-19.

On March 27, 2020, the **CARES Act** was signed into law and **provides temporary relief to insured depository institutions and credit unions** with the option to (1) **defer the implementation of CECL** potentially until December 31, 2020 and (2) **suspend requirements** under U.S. GAAP for certain **loan modifications to be considered TDRs** for loans not more than 30 days past due as of 12/31/2019. Deloitte anticipates the CARES Act's passage to trigger further guidance and clarification to be issued by the SEC, FASB, and/or banking agencies and will continue to monitor and update our publications accordingly.

[1] The interagency statement overlaps with the CARES Act but is not consistent in the determination of past due and loan modifications. Absent any further clarifications from SEC, FASB, and/or banking agencies, it would be prudent for entities to apply the guidelines established by the interagency statement given that is an interpretation of U.S. GAAP by banking agencies whereas the CARES Act indicates that GAAP can be suspended. In addition, the FASB issued a statement noting that the interagency statement "was developed in consultation with the staff of the FASB who concur with this approach".

Financial impacts and disclosures for banking and capital markets

Thinking through disclosures and messaging

Financial instruments | **Investor guidance** | **COVID-19-specific disclosures** | **MD&A and risk factors**

Financial instruments
- Consider providing additional insight into hedging programs and the impact from interest rate volatility and counterparty default exposure
- Address how credit risk, market illiquidity considerations, significant judgments in leveling conclusions, and broker/pricing services used affect FV measurements
- Disclose management's perspective on recovery (i.e., "U" vs. "L" shape) and assumptions sensitivity in the context of CECL estimates

Investor guidance
- Consider potential impacts on forecasts/guidance and provide updates to investors to manage expectations
- For analyst call preparation, perform sensitivity analysis around economic factors (e.g., interest rates, equity returns, etc.) and consumer/counterparty behavior, and be prepared to clearly communicate potential exposure

COVID-19-specific disclosures
- Communicate with Investor Relations and industry groups to identify most pertinent information. Impact on loan portfolio impairment, goodwill impairment, and security valuation from interest rate and market volatility are likely to be base level disclosures
- Assess need to update these disclosures in subsequent event footnote based on counterparty/consumer behavior post 3/31
- Include potential exposure due to industry and/or geo-graphic credit concentration risk

MD&A and risk factors
- Assess whether economic and market conditions or potential exposures are such that a risk factor needs to be added concerning COVID-19
- Tailor MD&A to discuss trends or uncertainties that have had, or are reasonably expected to have, a material impact on income or other indicators of financial health
- Consider adding ACL sensitivity related to COVID-19 in the MD&A

Internal control considerations

With the potential for additional disclosures, there will be new or adjusted quantitative calculations and data required to support those disclosures. Entities will need to ensure that they have properly designed and implemented controls related to the selection and application of GAAP for the accounting and disclosure issues. As such, companies should be proactive in assessing controls that will need to be designed and implemented over any newly-key EUCs, key reports, or business processes. Further, **as risk assessments are being performed and reviewed, the impact of COVID-19 should be considered as a factor** when determining ICFR risk in financial statement lines and business processes where the market and macroeconomic impacts are most felt.

Issuers are reminded that any changes in internal controls that have materially affected, or are reasonably likely to materially affect, entities' ICFR must be disclosed in Item 4 of Form 10-Q (or the equivalent).

Deloitte support

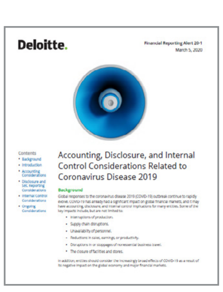
As your organization responds to the impacts stemming from COVID-19, Deloitte stands ready to help you tackle your most complex strategic, financial and operational issues. A sample of areas in which we can assist include:

Accounting, finance reporting BAU Support
- General accounting (US GAAP, IFRS)
- External financial reporting
- Management reporting
- Regulatory reporting
- Control support and guidance

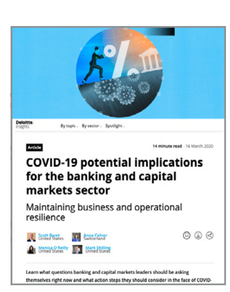
CECL, loss and impairment estimates
- Accounting policies and impairment memos
- Asset valuation services
- Loss model development and implementation
- Industry insight

Hedging, volatility, and risk management assessments
- Risk management strategy development
- Hedge accounting and effectiveness assessment frameworks
- Analytics and analysis
- FX exposure identification and mitigation

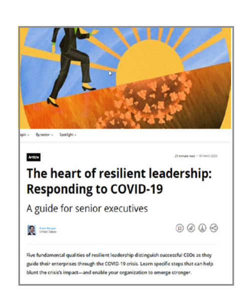
Deloitte Insight



Accounting, disclosure, and internal control considerations related to coronavirus disease 2019



COVID-19 potential implications for the banking and capital markets sector



The heart of resilient leadership: Responding to COVID-19

A guide for senior executives

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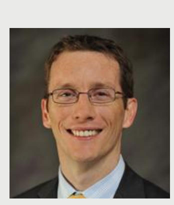

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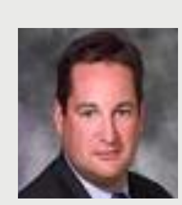

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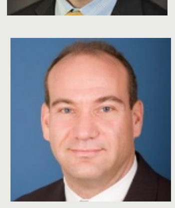

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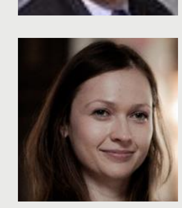

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