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Stop What You're Doing and Help the Fed

By Joseph Bonner
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With millions of Americans unemployed for the foreseeable future, the hard-working base of the economic ladder is suddenly very unstable and the entire economy is at risk.

Policymakers can no longer avoid this undeniable fact. The 20% unemployment rate floated last week by Treasury Secretary Steven Mnuchin seemed impossible to many at first, but few are disputing it days later.

Rome is burning. Credit unions and community banks are uniquely positioned to provide critical firefighting assistance, but to be part of any such program they must be prepared to step up in a big way.

In the first major departure from the 2008 playbook (pouring liquidity into the top of the economy) Mnuchin said Sunday that a top priority was "small business retention loans" to allow shuttered businesses to retain their employees for two weeks. That's a great idea but it may not be enough, though Mnuchin acknowledged that additional rounds of funding may be needed.

Regardless of how many funding rounds prove necessary, the Federal Reserve isn't equipped to process and disburse the vast number of loans needed to turn the tide. The Fed needs partners.

Instead of standing up a cottage industry of unregulated third parties to administer such loans — or turning the program over to the already overworked Small Business Administration — the Fed can get the most help in the shortest period of time to devastated small businesses by partnering with community banks and credit unions. These institutions already have deeply rooted connections with that segment of the economy.

At its core, the most impactful small business relief program would entail Fed emergency guaranties (not Fed loans) to: small businesses who can demonstrate they were financially viable before they were forced to shut down; and recently laid-off individuals who can prove they have a job to go back to if such loan guaranties keep their employer from failing before the pandemic is in the clear.

The criteria (eligibility, terms, etc.) for such small-dollar relief can be quickly established by the Fed, and the program rapidly implemented by community institutions with strong leadership.

For community banks to meet a challenge of this magnitude, and to seize this historic opportunity, they must clear the decks of virtually every other project.

Everything from new product rollouts to broader business development efforts must be postponed. Sales targets must be abandoned and mergers should be delayed.

Almost all available time, talent and resources must be rapidly mobilized and focused on processing and closing a very large number of small-dollar loans in a very short period of time.

Unfortunately, the combination of expediency and caution has been historically lacking for a fair number of community banks. This has fueled the rise of many fintech competitors who are further capitalizing on the crisis by emphasizing the built-in social distancing of their operating models.

With many community bank staffs already thinned by pandemic precautions, changing gears could prove even more challenging. But for those who espouse the vital role of community banks in a healthy economy, there is no better way to prove that position than by rapidly retooling to provide emergency assistance in a troubled economy.

Banking regulators must realize that encouraging banks to lend more by announcing flexibility on capital and liquidity standards is not nearly enough. Yes, adding more loans and deposits without raising additional capital will reduce capital ratios, and it's critical that financial institutions not be criticized for that.

But almost any small-dollar emergency loan will be unsecured and otherwise high risk. Small business borrowers have already suffered significant blood loss from which some will not recover.

And individual borrowers will not be the type of government employees who could immediately retire a short-term emergency loan after receiving their government guaranteed back pay.

Without the Fed guaranty, those emergency loans will likely result in increased loan losses that could, for some banks, lead to negative net income and even lower capital ratios. Thus, many institutions won't be able to help as much as hoped.

However, because of their already well established working relationships with individual banks and credit unions, federal regulators can make a loan guaranty program more consistent and transparent. They can do so by providing direct oversight of the specific loan portfolios, and higher-level reporting to Congress of program effectiveness.

Community banks and credit unions are only part of what must be a full-scale industrywide mobilization. The largest institutions can partner with the Fed to help major industries like airlines, large hotel chains and manufacturers.

Regional and smaller institutions can likewise partner with other wounded businesses whose scope and complexity are better suited to those institutions' underwriting and risk management processes. There's a critical role for everyone.

This is not a drill or a graduate school case study. If the badly-wounded small business segment of the economy can't stay afloat while the nation seeks to contain and ultimately, cure the coronavirus, a financial plague could spread faster than any biological one. If the Fed partners with community banks and credit unions to make small-dollar relief available very quickly on a large scale, it can make intervention actually work at the exact level where it's needed.

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