FINANCIAL INSTITUTION ACCOUNTING UPDATE

Adam Aucoin, Tax Senior Manager
Jeff Skaggs, Audit Principal/Practice Lead
Jordin Milano, Audit Manager
Karl Brorson, Vice President
Sean Madden, Audit Manager

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Today's Agenda

- The Allowance for Loan and Lease Losses (ALLL) trend discussion
- ALLL hot topics surrounding COVID-19
- Loan modifications and related considerations
- Paycheck Protection Program update
- Accounting topics refresh (TDRs and OREO)
- Tax
- Balance Sheet Strategies

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Today's Presenters

Adam Aucoin
Tax Senior Manager
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Adam is a senior manager in the tax practice at Baker Newman Noyes, specializing in serving banks and financial services institutions of all sizes. He joined the firm in 2012. In his role on the firm's banking and financial services industry team, Adam helps write, plan, and publish Issues of Interest, an email newsletter covering accounting, tax, and regulatory topics relevant to the banking industry.

JEFF SKAGGS
Audit Principal/Practice Lead
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Jeff is a principal at Baker Newman Noyes, specializing in delivering audit services to banks, trusts and financial services firms. Jeff has been with the firm since its founding in 1995. He is the leader of BNN's Financial Institutions Practice as well as the firm's Director of Quality Control. During his 30+ years servings banks, he has helped both large and small mutuals, SEC registrants, and institutions subject to FDICIA and SOX 404.

JORDIN MILANO
Audit Manager
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Jordin is a manager in the assurance practice at Baker Newman Noyes, specializing in providing auditing services to banks and financial institutions. Jordin has particular experience with mergers and acquisitions, and SOX 404 and FDICIA reporting. She joined the firm in July 2015.

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Today's Presenters

SEAN MADDEN

Audit Manager

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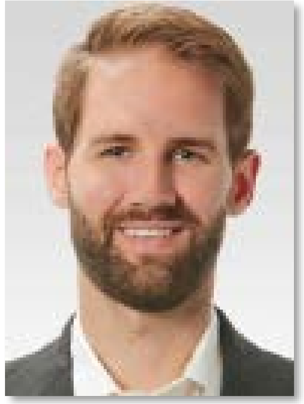
Sean is an assurance manager at Baker Newman Noyes, specializing in providing audit services to banks and credit unions. Sean has particular experience with internal controls, SEC and FDICIA reporting. Additionally, Sean has experience auditing benefit plans, including 401(k), pension and ESOP plans. He joined the firm in 2015.



KARL BRORSON

Vice President

Balance Sheet Strategy Group, Performance Trust

Karl joined Performance Trust in 2008. As a Vice President and educator at Performance Trust University®, Karl advises financial institutions in North America on how to effectively manage broad balance sheet strategies using total return and scenario analysis. Tapping into his background as a fixed-income analyst, Karl combines his knowledge and experience to execute strategies in conjunction with a disciplined risk/reward methodology. Prior to joining Performance Trust, Karl spent nearly two years at Newedge Financial working with asset managers in the futures options industry based in Chicago, IL. Karl graduated from North Park University in Chicago with a BA in Business and Economics and holds an MBA in Finance from Batterman School of Business. Karl also serves as President for the Financial Managers Society Boston Chapter.

The Allowance for Loan and Lease Losses

Trend Discussion

Where Are We Nationally?

- Q2 2020 net income down 70%
- Average ROA 0.36%. Down 102 basis points from a year ago
- Provision expense up 207% in Q2
- 61% of all banks reporting yearly increase in provision
- Net charge-offs up 22%

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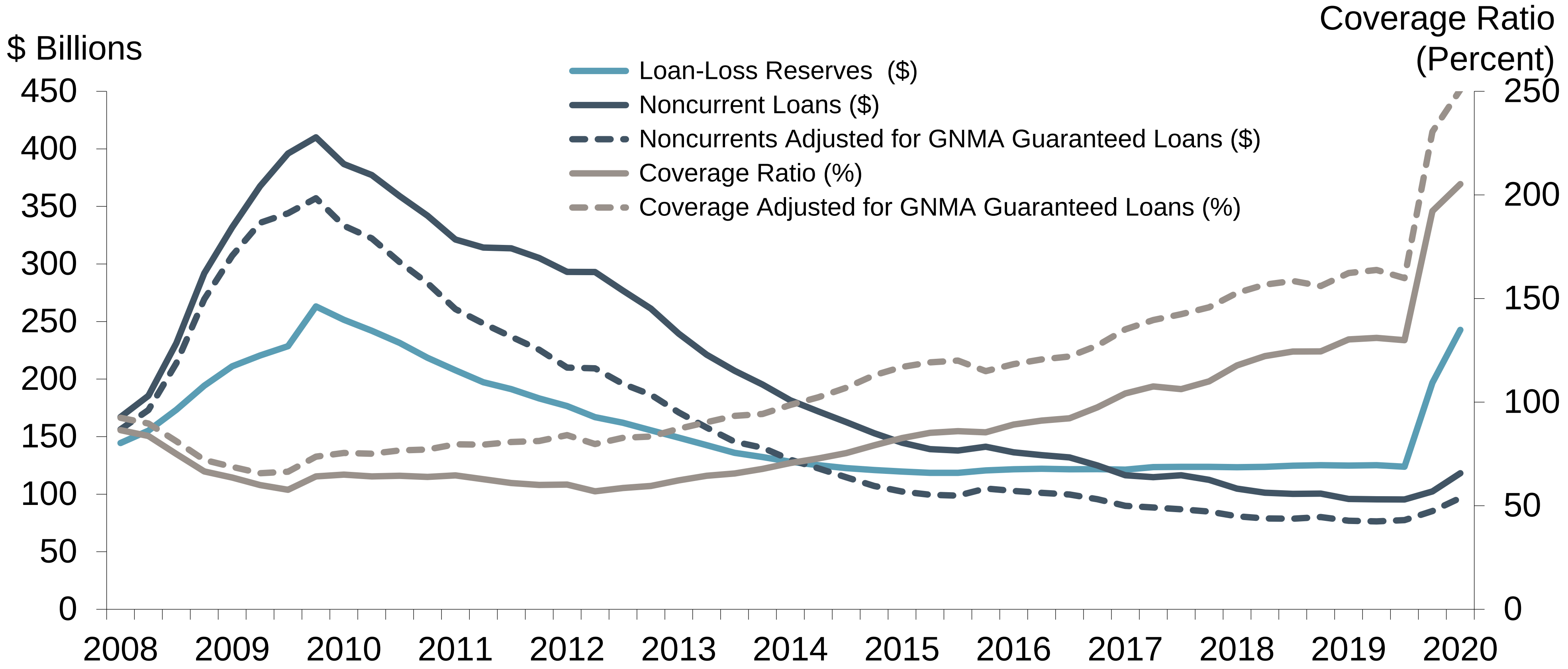
Reserve Coverage Ratio

All FDIC-Insured Institutions



Source: FDIC.

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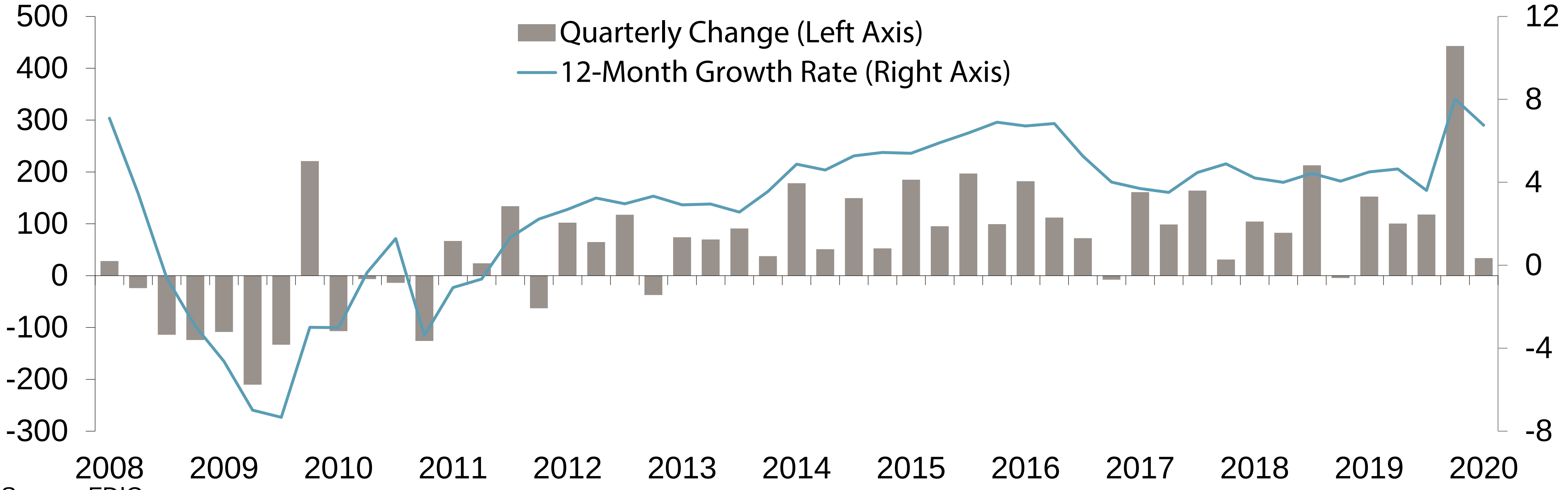
Quarterly Change in Loan Balances

All FDIC-Insured Institutions



Source: FDIC.

Note: FASB Statements 166 and 167 resulted in the consolidation of large amounts of securitized loan balances back onto banks' balance sheets in the first quarter of 2010. Although the total amount consolidated cannot be precisely quantified, the industry would have reported a decline in loan balances

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Where are we in New England?

BNN has observed 3 primary approaches to the ALLL model:

A. No changes to current model
  - All changes to the provision reflected in the current qualitative factors (primarily economic)

B. Changes were made to the loan pool segmentation
  - Examples include breakouts by industry type, risk rating, credit scores, etc.
  - In some cases a pool was created for loans that have been deferred multiple times and/or are considered "higher risk" due to COVID.

C. A separate COVID-19 related qualitative factor

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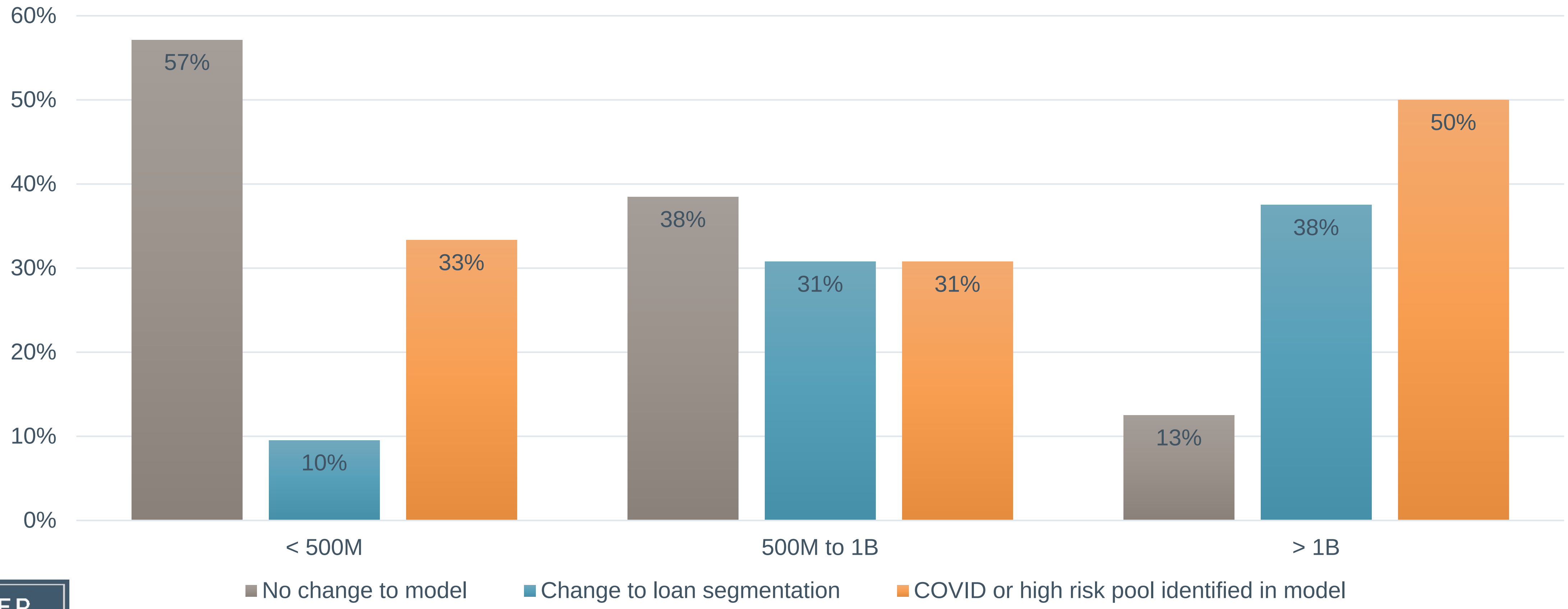
Changes to the ALLL Model by Bank Size



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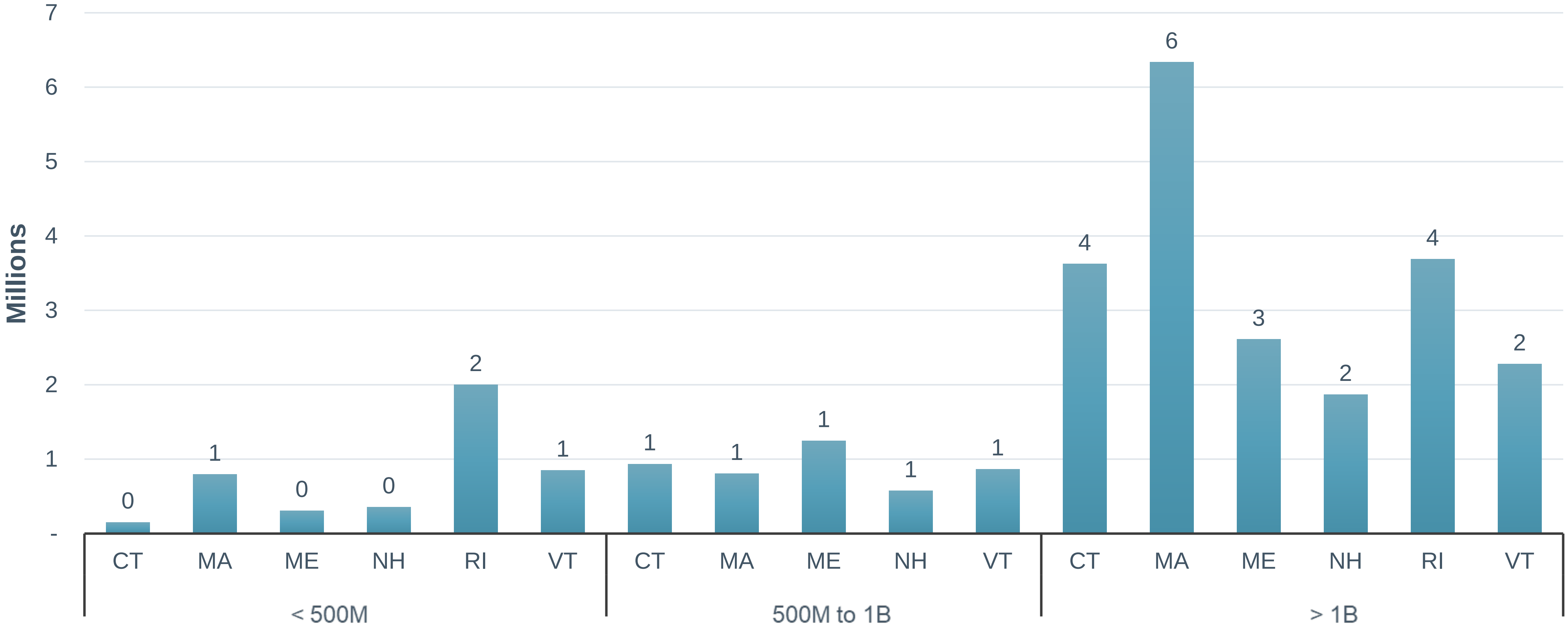
Average Increase in Provision by State (Q2)



Average	.6 million	.9 million	4 million

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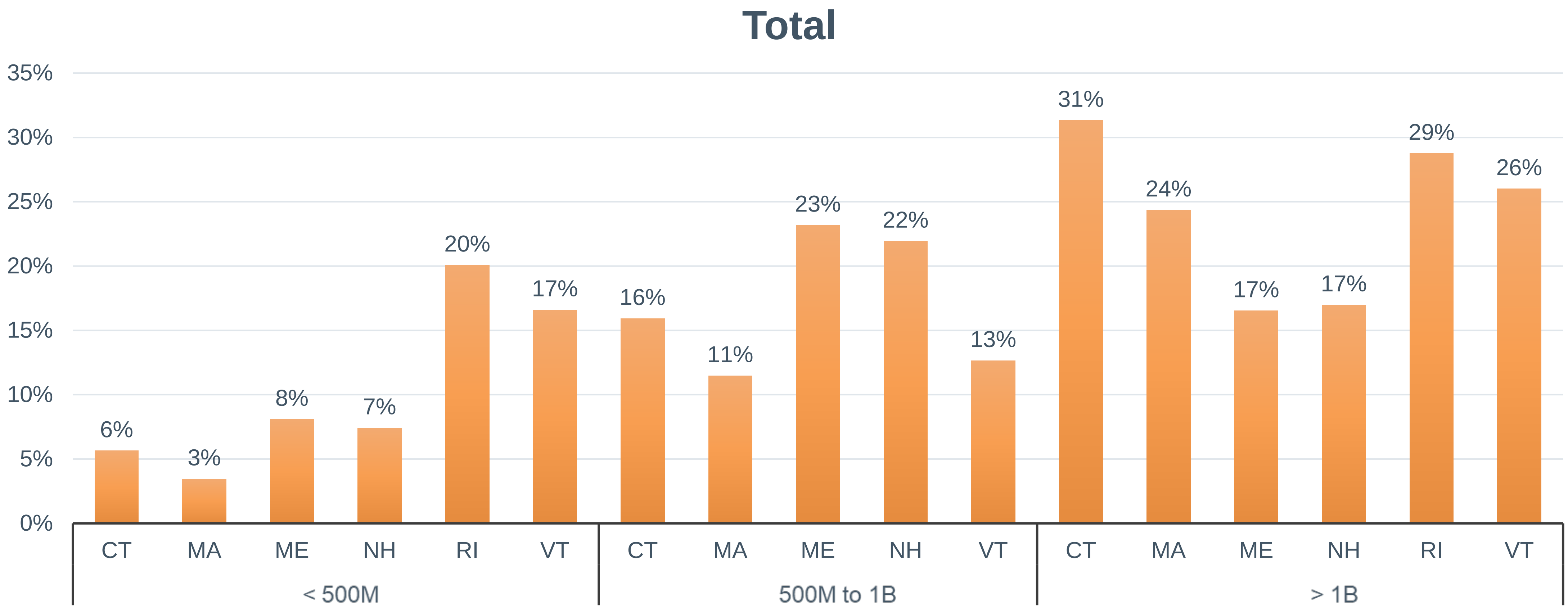
Percentage Increase to ALLL by State
(12.31.19 – 6.30.20)



	< 500M	500M to 1B	> 1B
Average	7%	14%	22%

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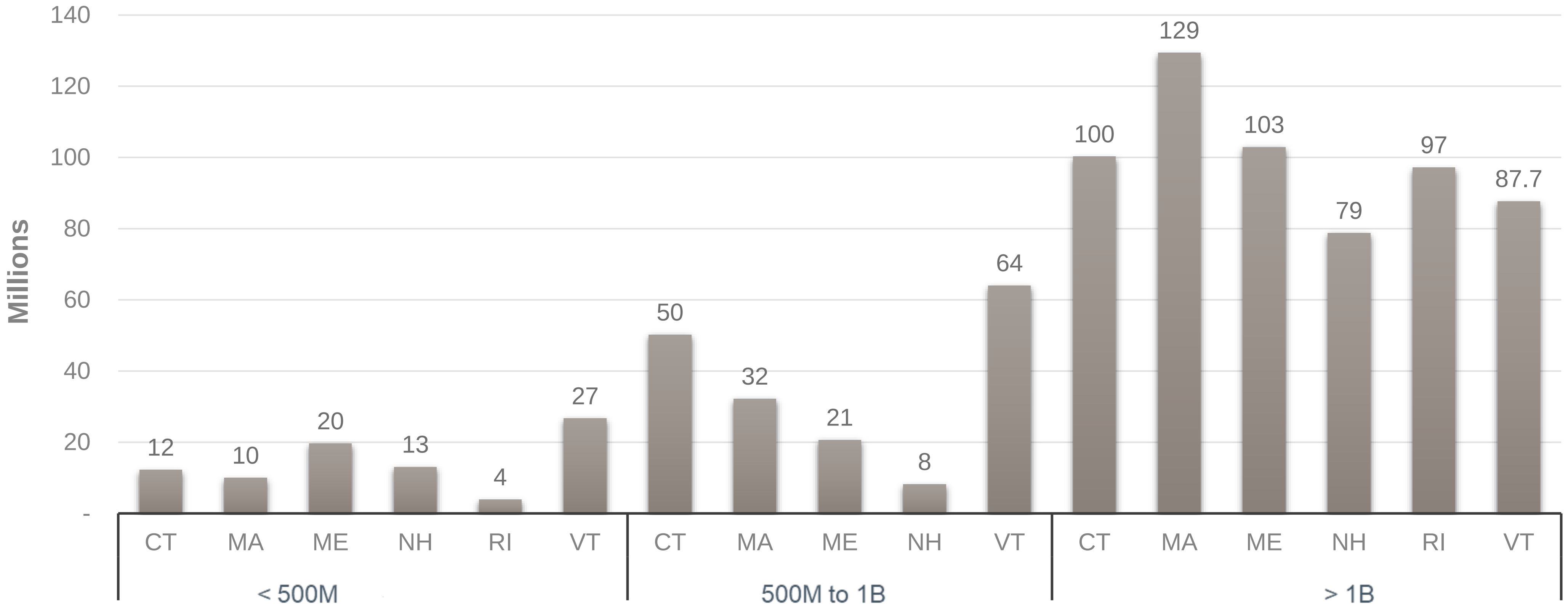
Average Balance of PPP Loans by State



Average	12 million	39 million	107 million

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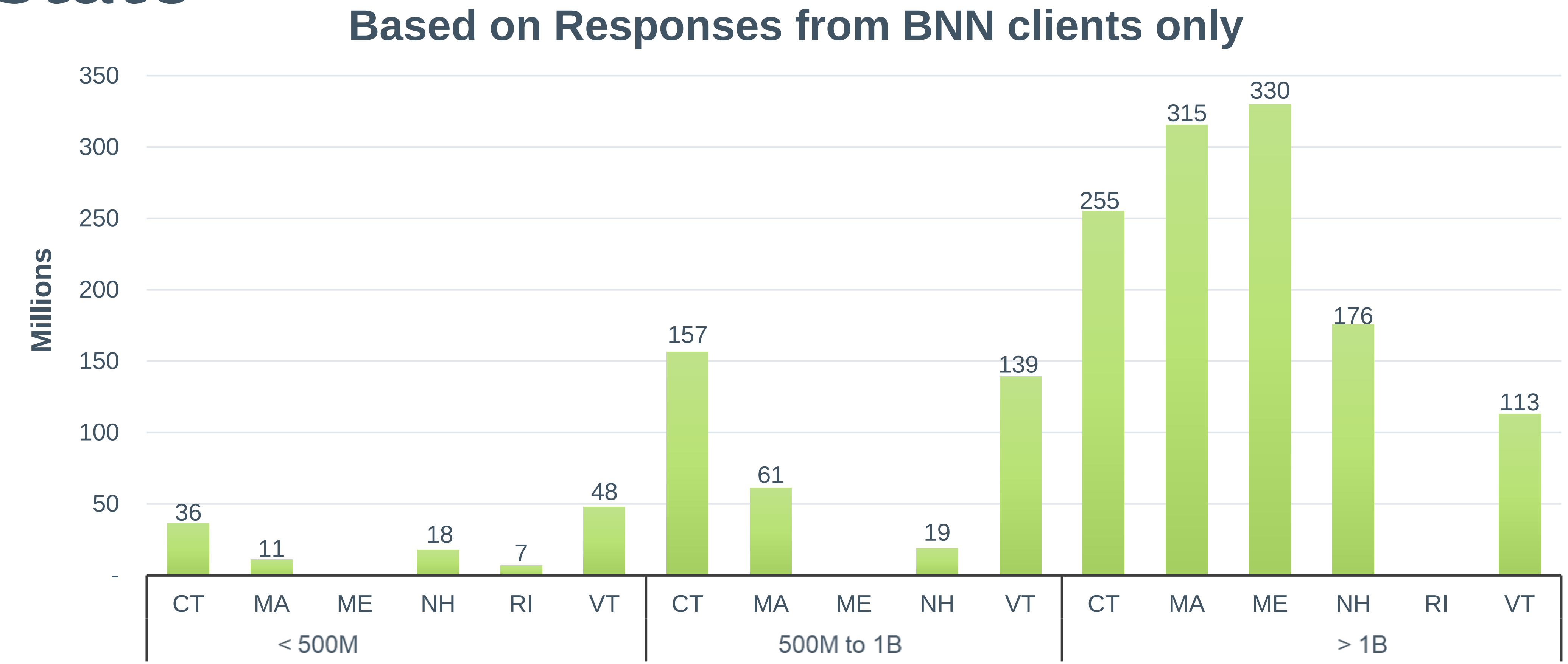
Average Balance of Deferred Loans by State



Average	19 million	87 million	275 million

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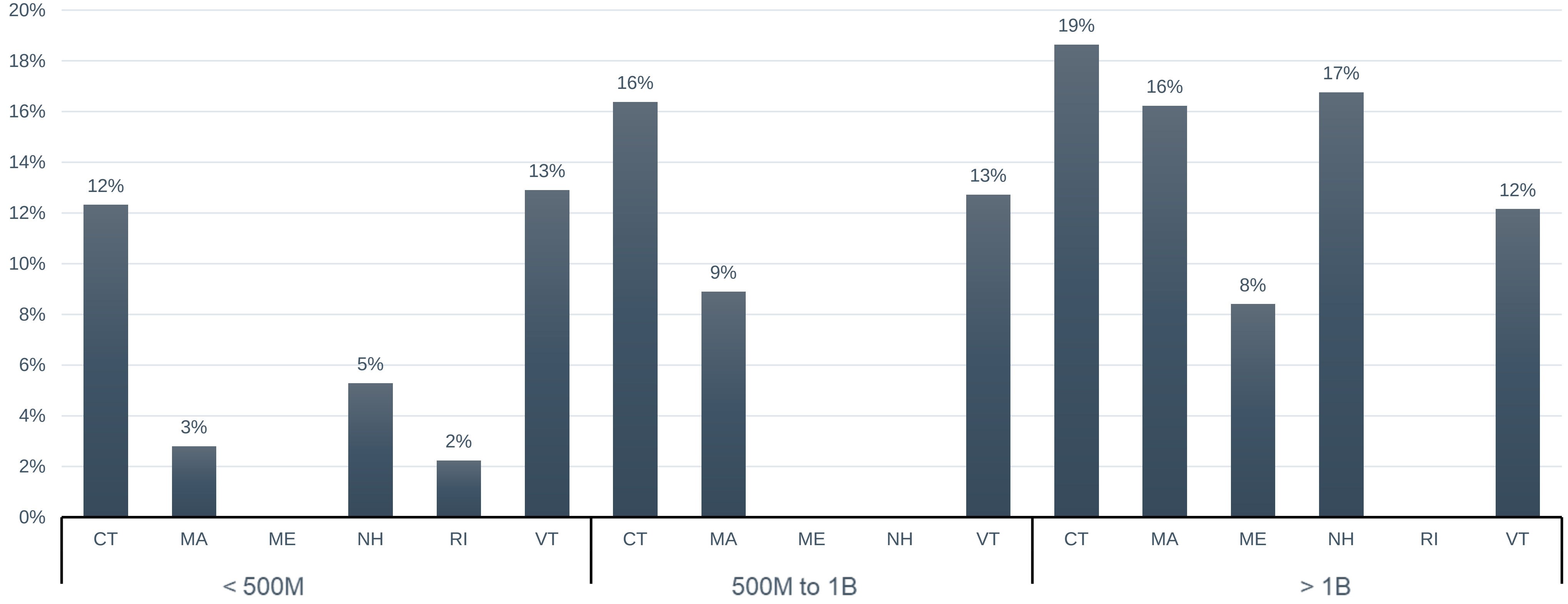
Deferred Loans as a % of Total Loans

Based on Responses from BNN clients only



Average	6%	10%	13%

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ALLL Hot Topics Surrounding COVID-19

Time for a polling question!

What is your institution's current historical loss lookback period?

Please take a moment to check in by answering our polling question. This helps us track engagement for CPE.

*The polling question will show on the screen for **one minute** and then we will resume the slides.*

THANK YOU for your patience while we give everyone the opportunity to respond.

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Credit Risk Considerations

- Revisit policies and procedures
- Revisit current lookback period used for historical losses
  - Determine what best represents the portfolio's current economic cycle
  - Consider whether or not lookback period should be shortened due to current economic conditions
- Review portfolio for industries which may need to be further analyzed, disclosed, or segmented within the ALLL model

Documentation, documentation, documentation!

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Loan Modifications and Related Considerations

Section 4013 of the CARES Act

- May be applied if:
  - Modification is COVID-19-related
  - Borrower not more than 30 days past due at December 31, 2019
  - Executed between March 1, 2020 and the earlier of:
    - 60 days after termination of the National Emergency, or
    - December 31, 2020

- Congressional override of TDR accounting rules (ASC 310-40)

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Interagency Guidance

- Apply when:
  - Modification does not qualify under Section 4013 or Section 4013 not elected
  - Modification is COVID-19-related
  - Borrower less than 30 days past due at time of modification program
  - Modification is short-term (e.g. six months)

- Interpretation, not an override, of ASC 310-40

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Modifications, Round 2 (and beyond)

- Section 4013
  - If aforementioned criteria under Section 4013 met – <u>not</u> a TDR

- Interagency guidance
  - Consider modifications on a cumulative basis
    - If six months or less in the aggregate, all COVID-19-related, and borrower less than 30 days past due at time of subsequent modification – <u>not</u> a TDR

- If neither of above can be met, look to regulatory reporting instructions and internal accounting policies

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To Accrue or Not Accrue

- What is the institution doing to monitor deferred loans for non-accrual status?
  - Delinquency status may be frozen due to modifications, therefore 90+ past due is not a triggering event.

- Consider reporting non-TDR modified loan as nonaccrual if:
  - Borrower declares bankruptcy post-modification
  - Loan officers are informed of significant negative events (i.e. permanent closure of business)
  - 90 days + past due at time of modification program but current at December 31, 2019
  - Significant deterioration in borrower credit post-modification

- Establish valuation allowance for accrued interest?

Paycheck Protection Program Update

Recent Developments

- What's going on in Congress
  - Where does this stand in terms of legislative priorities?
  - Possible standalone relief package for small businesses (PPP v2.0)?
    - Over $130B in unspent, earmarked PPP funds

- Ongoing advocacy related to:
  - Automatic forgiveness for PPP loans under certain $ amount (e.g. $150k)
  - Deductibility of expenses paid from forgiven PPP loan

- IRS Announcement 2020-12

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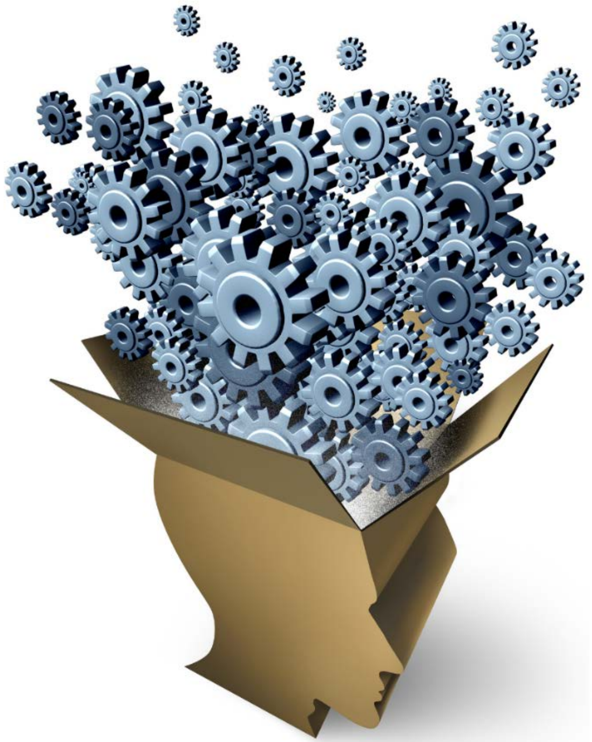
What Should Lenders be Thinking About?

- How has my participation in the program affected my balance sheet?
- Forecast timing of forgiveness
- Should an ALLL/ACL be recorded?
- Debt covenant considerations
- Fee income recognition timing
- Most importantly: work with your customers
  - Manage expectations (documentation, timing)
  - Proactively communicate as often as possible



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Accounting Topics Refresh

- ➢Troubled Debt Restructures
- ➢Impaired Loans
- ➢Other Real Estate Owned

Here's another polling question!

How often does your institution modify loans as TDRs?

Please take a moment to check in by answering our polling question. This helps us track engagement for CPE.

*The polling question will show on the screen for **one minute** and then we will resume the slides.*

THANK YOU for your patience while we give everyone the opportunity to respond.

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Troubled Debt Accounting Refresher

- ASC 310-40

- All loan modifications should be evaluated as potential TDR
  - Modification approval form should include TDR determination

- In light of COVID-19 TDR, TDR policies, procedures, and controls should be re-visited

- TDR status requires quarterly impairment evaluation and should be individually evaluated under ASC 310-10-35 (previously FAS 114)

Here's another polling question!

Does your institution use a TDR decision form when modifying loans?

Please take a moment to check in by answering our polling question. This helps us track engagement for CPE.

*The polling question will show on the screen for **one minute** and then we will resume the slides.*

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Is it a TDR?

- Borrower is experiencing financial difficulties
  - Evaluate financial condition of the borrower (payment status, bankruptcy, cash flows)
  - Collectability (is collection of principal dependent on collateral?)
- Creditor grants a concession that is more-than-insignificant
  - Payment delays under a restructuring may be insignificant if:
    - Restructured payments subject to delay are insignificant relative to UPB or collateral value
    - Delay in timing of restructured payments is insignificant relative to any of the following:
      - Frequency of payments due under the debt
      - Debt's original contractual maturity
      - Debt's original expected duration
- If debt previously restructured, consider all restructurings in aggregate
- Potential mitigating factors
  - Additional collateral provided or additional guarantors assigned

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Credit File Reviews

- What is the institution doing to remain in line with risk rating policy?
  - Are tracking reports being reviewed to ensure that this process is not falling behind?
  - In light of stale financial information, what should the Institution be doing?
    - Non-financial reviews
      - This can include obtaining updated credit reports, new appraisals/valuations, reviewing tax payments, site visits, documented discussions with borrowers, etc.
      - Obtain as much current/pro forma financial information from borrowers as possible
- Revisit policies and procedures
- What is the institution's risk rating approach for COVID-19 modified loans?

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Impaired Loans (ASC 310-10-35) (FAS 114)

- Impairment occurs when it is probable that the Institution will not collect all amounts due according to the contractual terms of the loan agreement (principal and interest)
  - Applies to all non-homogeneous loans (typically commercial)
  - Excludes loans that are measured at fair value or at the lower of cost or fair value
  - Similar definition to non-accrual, therefore most non-accrual commercial loans are by default, impaired

- TDR (troubled debt restructured) loans are always considered impaired
  - Once a TDR, always a TDR

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Impaired Loans (continued)

- So we have identified loans as impaired- now what?

<u>Measurement of Specific Reserves</u>

- Collateral dependent loan
  - A loan should be considered collateral-dependent when the only source of repayment expected is from the underlying collateral.
    - Specific Reserve = Proceeds expected to be received from the sale of the collateral net of selling costs – BV of the loan
    - Consider all selling costs, past due RE tax, etc. when performing evaluation
    - Ensure charge-offs recorded timely when foreclosure occurs

- Cash flowing loan
  - Repayment of the loan is dependent on the cash flows from operating the business or guarantor's financial support.
    - Specific Reserve = Present value of expected cash flows at the loan's effective rate- BV of the loan
    - Consider repayment ability of borrower – if consistent repayment not expected the loan may be collateral dependent

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Accounting Refresh – Other Real Estate Owned

- At the time of foreclosure/initial OREO evaluation:
  - Loan is transferred to OREO at the fair value of the property (net of selling costs)
  - Any shortfall is charged off through the ALLL
- Subsequent to initial evaluation:
  - Write-downs recorded through P&L
- Remember to consider need to obtain updated appraisals!

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OREO Sales – Seller Financed

- Changes with ASC Topic 610, Other Income and ASC Topic 606, Revenue from Contracts with Customers
  - Effective in 2019
  - Previous guidance required a specified down payment from the borrower based on property type, in order to recognize the gain on sale
  - New guidance is more principals based, requiring institutions to document their assessment of the borrower's ability to repay
  - Should not require significant additional work, but ensure documented as part of underwriting

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Resources

- BNN COVID-19 Resource Center: https://www.bnncpa.com/bnn-covid-19-resource-center/
- Treasury PPP Resource Center: https://home.treasury.gov/policy-issues/cares/assistance-for-small-businesses
- SBA PPP Resource Center: https://www.sba.gov/funding-programs/loans/coronavirus-relief-options/paycheck-protection-program
- COVID-19 Modification Flowchart: https://dart.deloitte.com/USDART/home/publications/deloitte/heads-up/2020/faq-tdr-cares-act-interagency-statement

Resources

- Interagency Statement on Loan Modifications and Reporting for Financial Institutions Working with Customers Affected by the Coronavirus (Revised), April 7, 2020: https://www.fdic.gov/news/press-releases/2020/pr20049a.pdf

- Joint Statement on Additional Loan Accommodations Related to COVID-19, August 3, 2020: https://www.ffiec.gov/press/PDF/Statement_for_Loans_Nearing_the_End_of_Relief_Period.pdf

- Interagency Examiner Guidance for Assessing Safety and Soundness Considering the Effect of the COVID-19 Pandemic on Institutions, June 2020: https://www.fdic.gov/news/press-releases/2020/pr20072a.pdf

- https://www.bnncpa.com/resources/is-it-a-troubled-debt-restructuring/

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Session Break!

Enjoy a short break while we transition to our next presentation.

See you again shortly!

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Financial Institutions Taxation:

Taxation During a Pandemic

Adam Aucoin, Tax Senior Manager

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Election and Future Considerations

Future Considerations

- 2020 election has potential to have major impact on tax rates and TCJA provisions

	PRESIDENT TRUMP	VICE PRESIDENT BIDEN
Corporate tax rate	21% (no change but some talk of going to 20%)	28%
Corporate AMT	N/A (no change)	Minimum tax on corporations with book profits of 100 million or more
Individual Rate	Extend current rates beyond 2025 sunset date and discussion around a middle-class tax cut	Increase top rate back to 39.6%
Capital Gain Tax Rate	0/15/20% (no change)	Top rate increase to 39.6% for taxpayers earning over $1 million

Future Considerations

	PRESIDENT TRUMP	VICE PRESIDENT BIDEN
Payroll Tax	No changes (however has commented before to be cut or eliminated)	Eliminate wage base for taxpayers with income over $400,000
199A Deduction	Extend beyond 2025 sunset date	Phasing out deduction for taxpayers with income over $400,000
Child Tax Credits	No change (max of $2,000 per child for child tax credit)	Expand EITC, dependent care credit, child tax credit, and increase child care credit

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Future Considerations

- Tax rates going up would be the reverse of what occurred after the rate went down:
  - o Would try to accelerate income and defer deductions
    - – Depreciation
    - – Prepaid expenses
    - – Accrued compensation
    - – Pension and retirement plan contributions
    - – Deferred revenue contracts
  - o Would change pricing and value of BOLI, municipal investments, and other tax exempt vehicles
  - o Banks with DTAs would record tax benefits due to the deferred tax asset revaluation

Future Considerations

- Example 1: Bank of BNN is considering whether to elect out of bonus depreciation and not utilize Section 179 on it's 2021 return. Assume effective for 2022 the tax rate will increase from 21% to 28%.
  - Tax Depreciation with bonus depreciation: $1,500,000
  - Tax Depreciation if opt out of any first-year bonus depreciation or Section 179: $500,000
  - Taxable income would be $1,000,000 greater in 2021 if opt out of bonus and the $1,000,000 will be deductible at 28% in the future over the tax depreciable lives of the assets.
  - The deferred tax asset at 21% related to this would be $210,000 ($1,000,000 * 21%). At the end of the year the deferred tax asset would need to be re-valued to 28%. As a result $1,000,000 * (28% - 21%) = $70,000. This amount would be recorded as a tax benefit on the income statement.

Other Considerations in Light of the Current Economic Situation

DEBT & LOAN CONSIDERATIONS

- TDRs – Troubled Debt Restructurings
  - If a loan has a significant modification the tax and GAAP results may differ.
  - If a loan restructuring rises to the level of "significant" then for tax the loan is considered sold and gain (or loss) would need to be recognized which would likely create a timing difference.
  - Two part test to determine if "significant"
  - Part 1: Loan must be modified which is an alteration to the legal rights of the borrower
  - Part 2: Determine if "significant"
    - There are a number of IRS provided methods and tests for this but the main point is the loan would be economically different.
    - In general a forbearance that is 2 years or less will not be significant.
    - Modification is significant if the debt's yield changes by the greater of 25 basis points or 5% of the unmodified debt's yield (fees should be kept in mind when determining a change in yield if the fee is treated as interest).
    - Potential for significant modification if timing of payments creates a material deferral. Safe harbor available for the lesser of 5 years or 50% of the original term.
  - Takeaway: Any large or longer lasting debt restructurings might need to be analyzed for potential tax differences.

DEBT & LOAN CONSIDERATIONS

- Deferred Interest
  - Nonaccrual interest (absent a bad-debt conformity method) remains taxable unless the interest is deemed not collectible.
  - Possible that some loans may be deferring interest income for GAAP and not be on nonaccrual due to COVID-19 and Cares Act considerations. Interest may still be taxable on these loans similar to nonaccrual loans and a timing difference created between book and tax.
- Bad Debt
  - In general for tax bad debt deductions are determined under Section 166 for net charge offs or for banks with $500 million or less of total assets might be determined under Section 585 using the experience and/or reserve method.
  - Given the uncertain economic times bad debt provisions may increase and careful consideration may be needed for timing of charge offs.
  - Conformity election is availability to match the timing of charge offs for tax and as reported to regulators.
- OREO
  - Deduction allowed for initial charge-off
  - Subsequent write-downs are not deductible until sold

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STATE TAX CONSIDERATIONS

- Employees working from home
  - Do they work in a state the bank currently does not have nexus in?
  - Is the work from home situation temporary due to COVID-19 or expected to last?
  - Payroll tax consideration for remote employees.
  - Rules vary state by state for remote working and some states have short-term COVID-19 exceptions.

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Time for a polling question!

Has your institution considered potential tax rate changes when budgeting and/or planning for the next few years?

Please take a moment to check in by answering our polling question. This helps us track engagement for CPE.

*The polling question will show on the screen for **one minute** and then we will resume the slides.*

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Parking Expense Update

Historical Background

- December 2017: Congress passed *Tax Cuts and Jobs Act* (TCJA), which disallows a deduction for qualified transportation fringes (QTFs) provided by taxpayers to their employees.
- December 2018: IRS issued guidance in [Notice 2018-99]
- June 19, 2020: IRS issued [Proposed Regulations]

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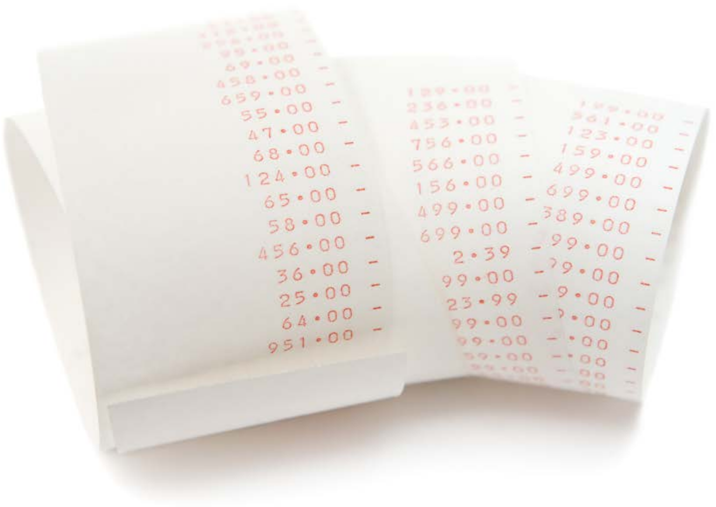
Qualified Transportation Fringe Benefits (continued)

- Expenses to be disallowed if primary use is employee parking. Type of costs include, but are not limited to: repairs, maintenance, plowing, utilities, insurance, taxes, rent, interest, trash removal, cleaning, landscape costs, and security. It does not include depreciation.
- Lot aggregation (or disaggregation is allowed) within the same city under Notice 2018-99 (under proposed regulation lots need to be contiguous):
  - If bank had a headquarter and two other locations in the same city they could aggregate all 3 locations into one lot and see if the primary use changes using Notice 2018-99.
  - It could be beneficial to disaggregate the lots if for example the primary use is employee parking when aggregated but when you disaggregate you can remove certain costs from the calculation such as security at one lot.



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Qualified Transportation Fringe Benefits – Notice 2018-99 vs. Prop. Regs

- Proposed regulations issued in June 2020 mostly follow the guidance of Notice 2018-99 but do provide a few new definitions and changes.
- The proposed regulations provide there are three methods (in addition to the general rule) to calculating the disallowance. (Details to follow)
- 5% shortcut method added by Proposed Regs: When using any of the special methods (#s 2 through 4), an employer can choose to allocate 5% of the following mixed expenses to a parking facility: lease payments, property taxes, interest expense, and the cost of utilities and insurance. This cannot be used with the general method.

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Method #1

Method #1: General Rule

- Employer can use any reasonable method, with the following caveats:
  - Must use cost, not value, to determine the nondeductible amount
  - Cannot deduct expenses related to reserved employee spaces
  - Cannot improperly apply the exception for qualified parking made available to the general public

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Method #2

Method #2: Qualified Parking Limit Methodology (newly added by Proposed Regs)

- The disallowed amount is the product of (a) the number of spaces used by employees during the peak demand period times (b) the monthly Section 132(f)(2) limitation on tax-free employee parking.
- The limitation is adjusted for inflation and, for 2020, is set at $270 per month.
- This method is simple, but will likely result in a high amount of disallowance.

Method #3

Method #3: Primary Use Methodology (carried over from Notice 2018-99)

- This method consists of 4 steps

Step #1: Calculate the disallowance for reserved employees spaces

Step #2: Determine the primary use of the remaining available parking spaces

Step #3: Calculate the allowance for reserved nonemployee spaces

Step #4: Allocate the remaining costs to the total number of available spots used during peak period

Method #4

Method #4: Cost per space methodology (newly added by Proposed Regs)

- Multiply the cost per space by the total number of available spaces used by employees during the peak demand period.
- This method might result in savings if there are a significant number of reserved employee spots that are not used during peak demand period.

Qualified Transportation Fringe Benefits – Notice 2018-99 vs. Prop. Regs

- **Other Key Definitions:**
  - Geographic location – Contiguous tracts of land that share at least one common boundary
  - Inventory/unusable spaces - The term inventory/unusable spaces means the spaces in the parking facility, or the taxpayer's portion thereof, exclusively used or reserved for inventoried vehicles, qualified nonpersonal use vehicles described in §1.274-5(k), or other fleet vehicles used in the taxpayer’s business, or that are otherwise not usable for parking by employees. Examples of such parking spaces include, but are not limited to, parking spaces for vehicles that are intended to be sold or leased at a car dealership or car rental agency, parking spaces for vehicles owned by an electric utility used exclusively to maintain electric power lines, or parking spaces occupied by trash dumpsters (or similar property).
  - Peak demand period. The term peak demand period refers to the period of time on a typical business day when the greatest number of the taxpayer’s employees are utilizing parking spaces in the taxpayer’s parking facility. If a taxpayer’s employees work in shifts, the peak demand period would take into account the shift during which the largest number of employees park in the taxpayer’s parking facility. However, a brief transition period during which two shifts overlap in their use of parking spaces, as one shift of employees is getting ready to leave and the next shift is reporting to work, may be disregarded. Taxpayers may use any reasonable methodology to determine the total number of spaces used by employees during the peak demand period on a typical business day. A reasonable methodology may include periodic inspections or employee surveys.

BAKER NEWMAN NOYES

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Time for another polling question!

Did you reduce your workforce in 2020 and if so by how much?

Please take a moment to check in by answering our polling question. This helps us track engagement for CPE.

The polling question will show on the screen for ***one minute*** *and then we will resume the slides.*

THANK YOU for your patience while we give everyone the opportunity to respond.

BAKER NEWMAN NOYES

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COVID-19 Related Payroll Tax Credits and Deferrals

PAYROLL TAX CREDITS

- **<u>Emergency Paid Sick Leave</u>**
    - Applies to most employers under 500 employees
    - If fewer than 50 employees there is potential to be exempted
- Full time employees are entitled to 80 hours of paid sick leave, with part-time employees receiving a prorated amount. The leave is paid at the following rates:
- At the employee's regular rate of pay, with the payment capped at $511 per day, if the employee: (a) is subject to a governmental quarantine order; (b) has been advised by a health care provider to self-quarantine or (c) is experiencing symptoms of COVID-19 and seeking a medical diagnosis.
- At two thirds of the employee's regular rate of pay, with the payment capped at $200 per day, if the employee: (a) is caring for a quarantined individual; (b) is caring for the employee's child if the child's school has been closed or does not have day care available; or (c) is experiencing a situation that the Secretary of Labor deems to be similar to these conditions.
- Payroll tax credit for 100% of the payments made under the provisions.

BAKER NEWMAN NOYES

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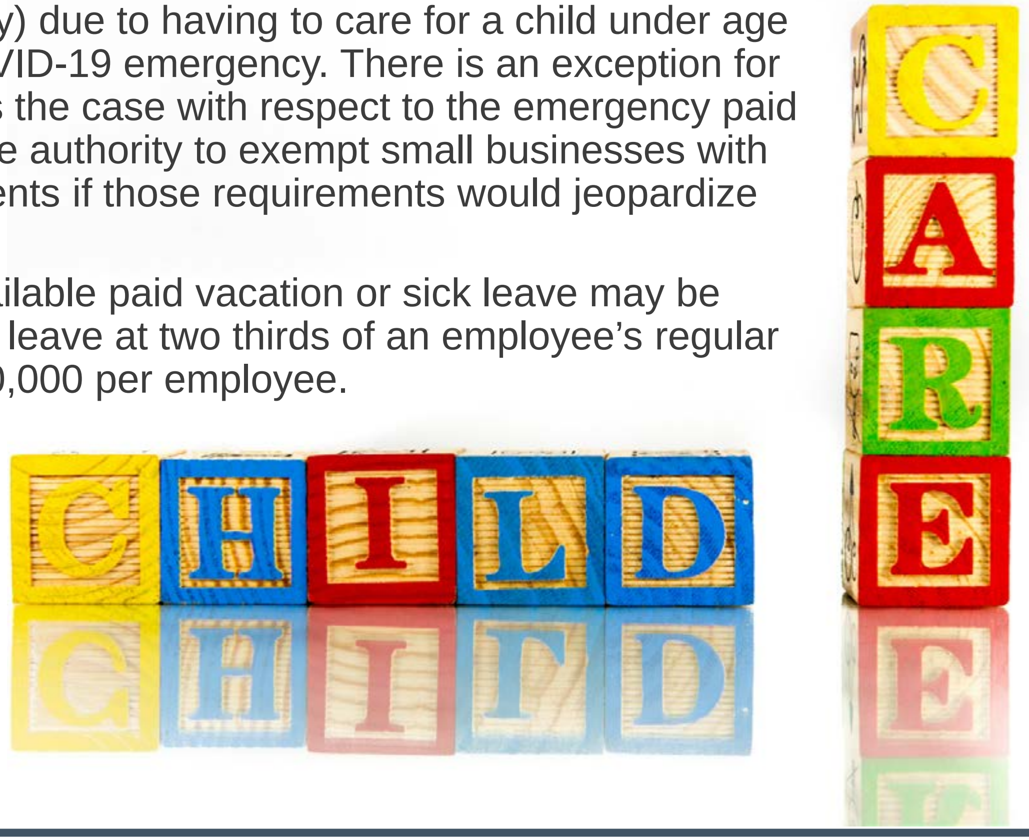
PAYROLL TAX CREDITS (continued)

- **<u>Expansion of FMLA</u>**
  - The Act allows employees of employers with fewer than 500 employees to take up to 12 weeks of job-protected leave if they are unable to work (on site or remotely) due to having to care for a child under age 18 whose school or day care facility is closed due to the COVID-19 emergency. There is an exception for health care providers and emergency responders. Also, as is the case with respect to the emergency paid sick leave provisions, the Act gives the Secretary of Labor the authority to exempt small businesses with fewer than 50 employees from the bill's paid leave requirements if those requirements would jeopardize the viability of the business.
  - The first 10 days of leave may be unpaid, although other available paid vacation or sick leave may be used. After 10 days, the employer is required to provide paid leave at two thirds of an employee's regular rate of pay, up to $200 per day, with an aggregate cap of $10,000 per employee.
  - Payroll tax credit for 100% of the payments made under the provisions.



BAKER NEWMAN NOYES

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PAYROLL TAX CREDITS (continued)

- **Employee Retention Credit**
  - Provides eligible employers with a credit against their Section 3111(a) payroll taxes equal to 50% of the qualified wages paid to each employee in a quarter, up to a maximum of $10,000 in wages.
  - Applicable for qualified wages paid from March 13, 2020 through December 31, 2020.
  - Employers are eligible for the credit if they meet one of two tests:
    - *1) carry on a trade or business during calendar year 2020 whose operations were fully or partially suspended during the calendar quarter due to orders from an appropriate governmental authority limiting commerce, travel, or group meetings (for commercial, social, religious, or other purposes) due to COVID-19 AND/OR*
    - *2) starting with the quarter in which they experienced a decline in gross receipts of at least 50% for the calendar quarter as compared to the same calendar quarter in the prior year, and ending with the first calendar quarter beginning after a calendar quarter in which gross receipts are greater than 80% of the gross receipts for the same calendar quarter for the prior year.*

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PAYROLL TAX DEFERRAL - EMPLOYER

- Potential for deferral of the 6.2% employer portion of the Social Security tax (Medicare tax deferral is not available)
- For periods from March 27, 2020 until December 31, 2020.
- 50% of the deferred taxes must be deposited by December 31, 2021, and the remaining 50% must be deposited by Dec. 31, 2022.
- Employers who receive payroll tax credits for the employee retention credit, expansion of FMLA credit, or emergency sick paid leave credit are still eligible to defer the employer portion of the Social Security tax.
- Timing of deduction could be altered by deferral of payments depending on facts and circumstances.

BAKER NEWMAN NOYES

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PAYROLL TAX DEFERRAL - EMPLOYEE

- On August 8th a Presidential directive was announced related to deferral of employee payroll taxes for the 6.2% of Social Security Taxes. This was followed by Notice 2020-65 that provided guidance on implementation.
- The notice followed the states that the deadline for withholding and depositing the employee share of the 6.2% Social Security tax is deferred. For compensation paid beginning September 1 and ending on December 31 of this year, the normal monthly or semiweekly deposit schedule is ignored, and the amounts instead are due ratably between January 1 and April 30 of 2021.
- Deferral applies to both the withholding of tax from the employee and depositing of funds with the IRS.

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PAYROLL TAX DEFERRAL - EMPLOYEE

- Applies only if the amount of such wages or compensation paid for a bi-weekly pay period is less than the threshold amount of $4,000 or the equivalent threshold amount with respect to other pay periods. Note that this is **not** worded “compensation **up to** $4,000.” It instead describes a hard cut-off that allows the deferral for employees whose compensations are under this amount during the period in question, and prohibits it completely for employees whose compensations exceed it.
- Participation appears voluntary
    - Questions arise in the case of retirement and termination of employee before deferral is over

BAKER NEWMAN NOYES

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Here's our last polling question!

When do you expect to get back to pre-pandemic travel levels (including customer visits, conferences, etc.)?

Please take a moment to check in by answering our polling question. This helps us track engagement for CPE.

*The polling question will show on the screen for **one minute** and then we will resume the slides.*

THANK YOU for your patience while we give everyone the opportunity to respond.

BAKER NEWMAN NOYES

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CARES Act Considerations for Financial Institutions

OTHER CARES ACT CONSIDERATIONS

- Qualified Improvement Property (“Retail Glitch” fix)
  - o Under TCJA qualified improvement property was 39 year property and not eligible for bonus depreciation
  - o CARES act fixed the glitch so qualified improvement property is now 15 year property eligible for bonus depreciation
- NOL Carryback provisions
  - o 5 year carryback allowed for NOLs occurring 2018-2020
    - – 2018 loss carried back first to 2013 then to 2014, 2015, 2016, and lastly 2017
    - – 2019 loss carried back first to 2014 then to 2015, 2016, 2017, and lastly 2018
    - – 2020 loss carried back first to 2015 then to 2016, 2017, 2018, and lastly 2019
  - o Carryback potentially could be to a year with a higher tax rate for permanent savings
  - o NOLs arising before 1/1/2021 can offset income 100% and are not subject to the 80% limitation created by TCJA
  - o Consideration should be given to M&A activity for final return losses already occurring or expected to occur

OTHER CARES ACT CONSIDERATIONS
(continued)

- Refundable AMT Credits
    - AMT eliminated for C Corps in TCJA and AMT credits were refundable starting 2018 through 2021
    - Under CARES act most AMT credits fully refundable in either 2018 or 2019
- Business Interest Expense Limitation (163(j))
    - Increases limitation from 30% to 50% of taxpayer's adjusted taxable income for 2019 & 2020 and for 2020 may elect to use 2019's adjusted taxable income
    - A partnership cannot use the increased 50% of adjusted taxable income for the 2019 tax year and must continue to use the existing 30% limit. For partners that were allocated disallowed interest in 2019 from a partnership, unless they elect out, in 2020 the partner will be able to deduct 50% of the limited interest and the other 50% will be subject to the existing rules

BAKER
NEWMAN
NOYES

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Back and to the Future….

October 27th, 2020

Karl Brorson
Vice President | Balance Sheet Strategy Group
Performance Trust Capital Partners, LLC

AGENDA

- Community Banking: Fulfilling The Mission
- Fundamentals & Current Market
- Risk & Earnings: The New Normal
- Strategic Approach To Balance Sheet

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Polling Question #1

Has your institution been actively involved in providing PPP loans?

- Yes
- No

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Living Up To Your *Mission*:

*Your community financial institution has been living up to your mission statement by serving on the **front lines** of our financial crisis as a result of Covid-19:*

- *helping mitigate economic losses by providing life support for business via PPP*
- *staying open while other businesses are closed*
- *assisting borrowers on personal loans on case-by-case basis*
- *generating liquidity in a time of financial stress*
- *remaining the heartbeat of the community and greater New England market*

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PPP Program

BUSINESS

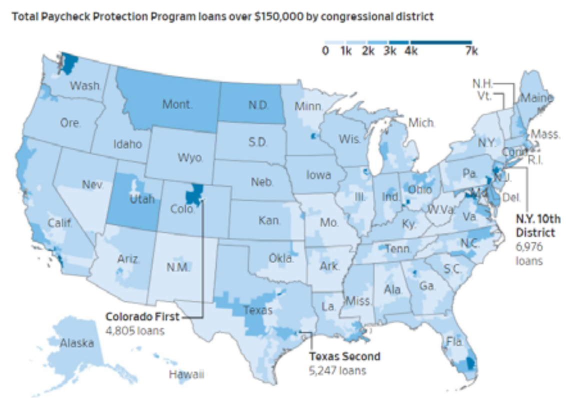
When Their PPP Loans Didn't Come Through, These Businesses Broke Up With Their Banks

Some owners are moving their money permanently to smaller banks that were able to deliver their PPP funds

By Peter Rudegeair
July 31, 2020 10:38 am ET

Paycheck Protection Program

An SBA loan that helps businesses keep their workforce employed during the Coronavirus (COVID-19) crisis.



Forbes

1,140 views | Jun 17, 2020, 02:51pm EDT

Community Banks Met The Challenge Of The SBA's PPP Funding

Tom Groenfeldt Contributor
Enterprise Tech
I write about finance and technology.

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Fundamental Truism:

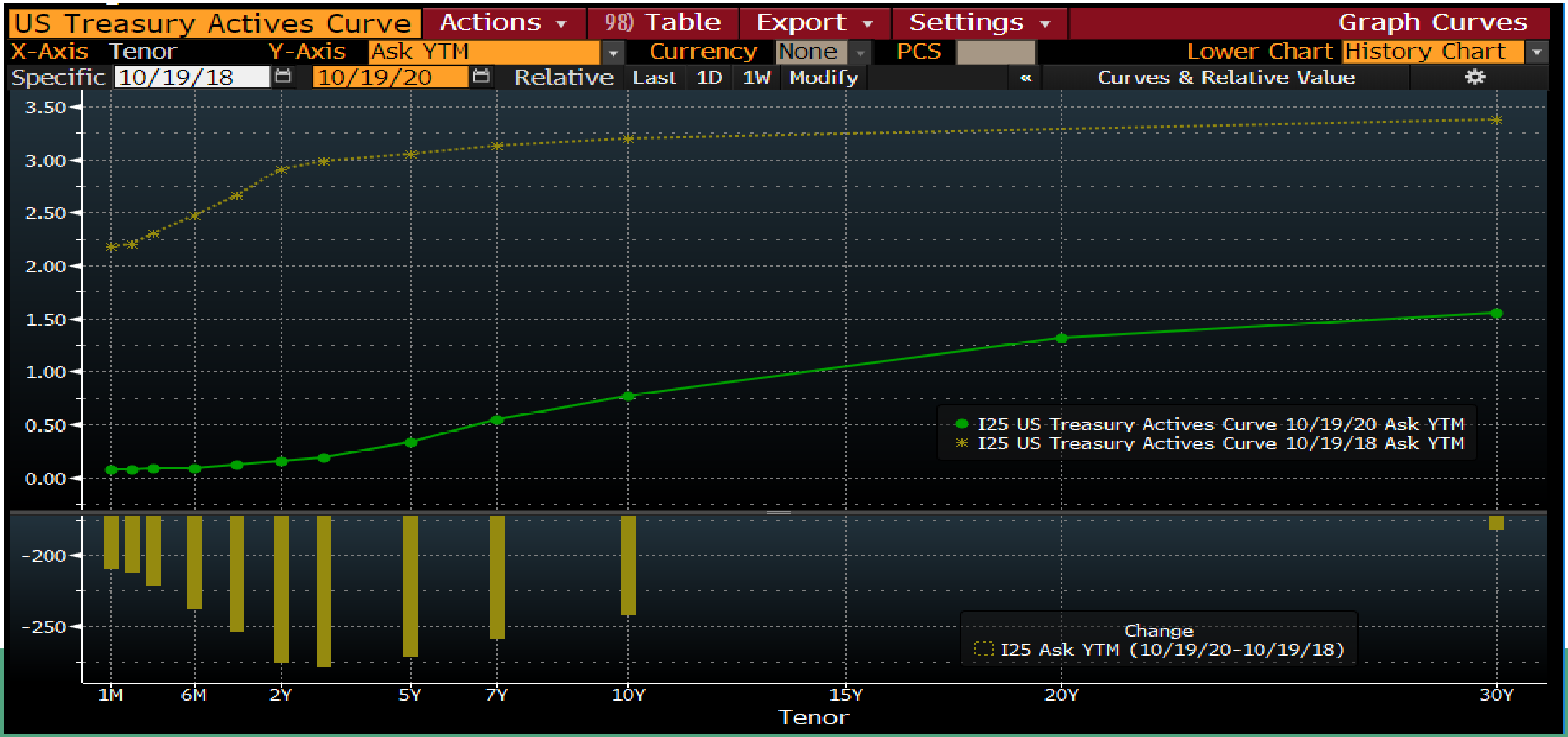
I can’t predict interest rates.

You can’t predict interest rates.

No one can predict interest rates.

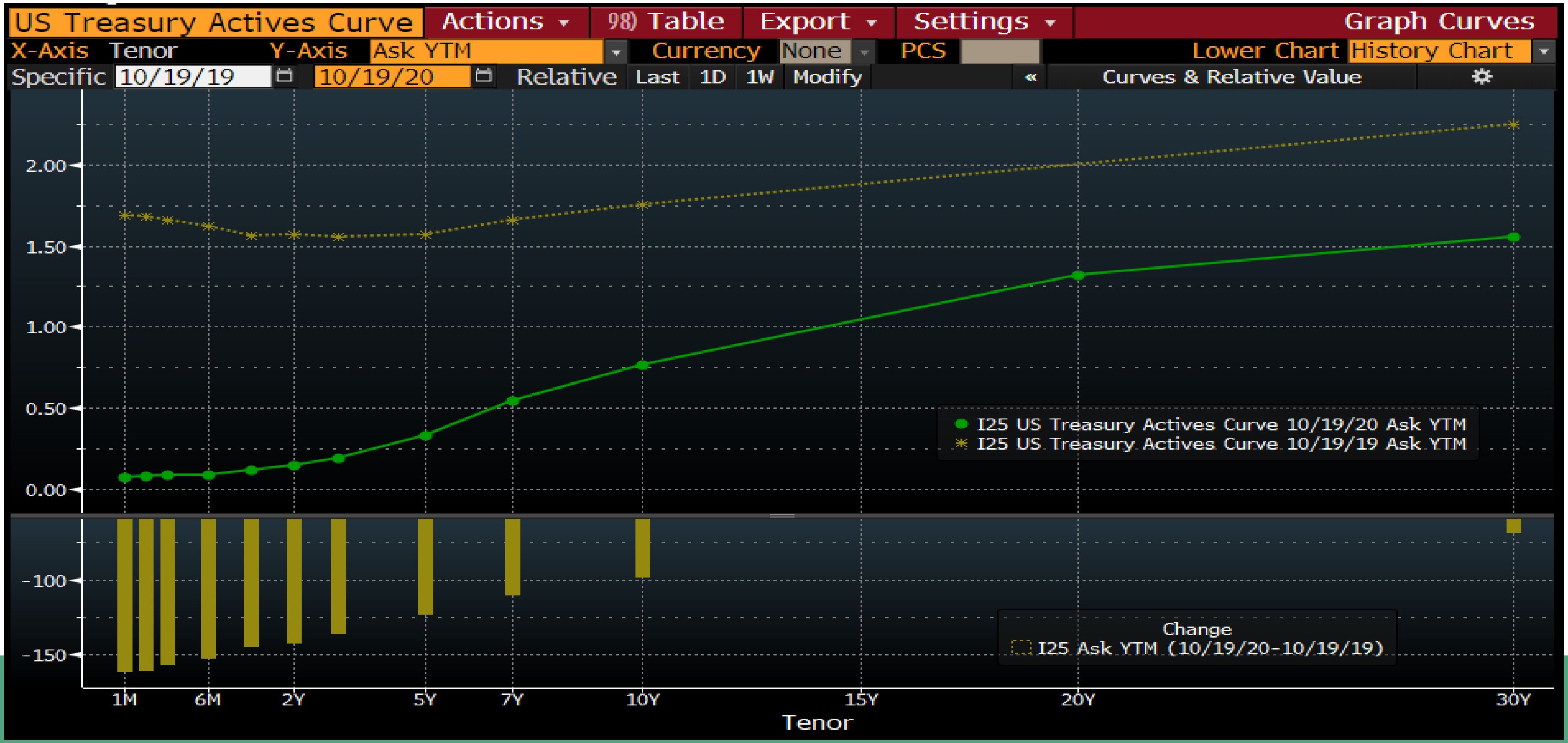
With a look back over time, we can objectively understand why it is important to measure outcomes of all possible future rate scenarios

Yield Curve Changes: 2 Years Ago…



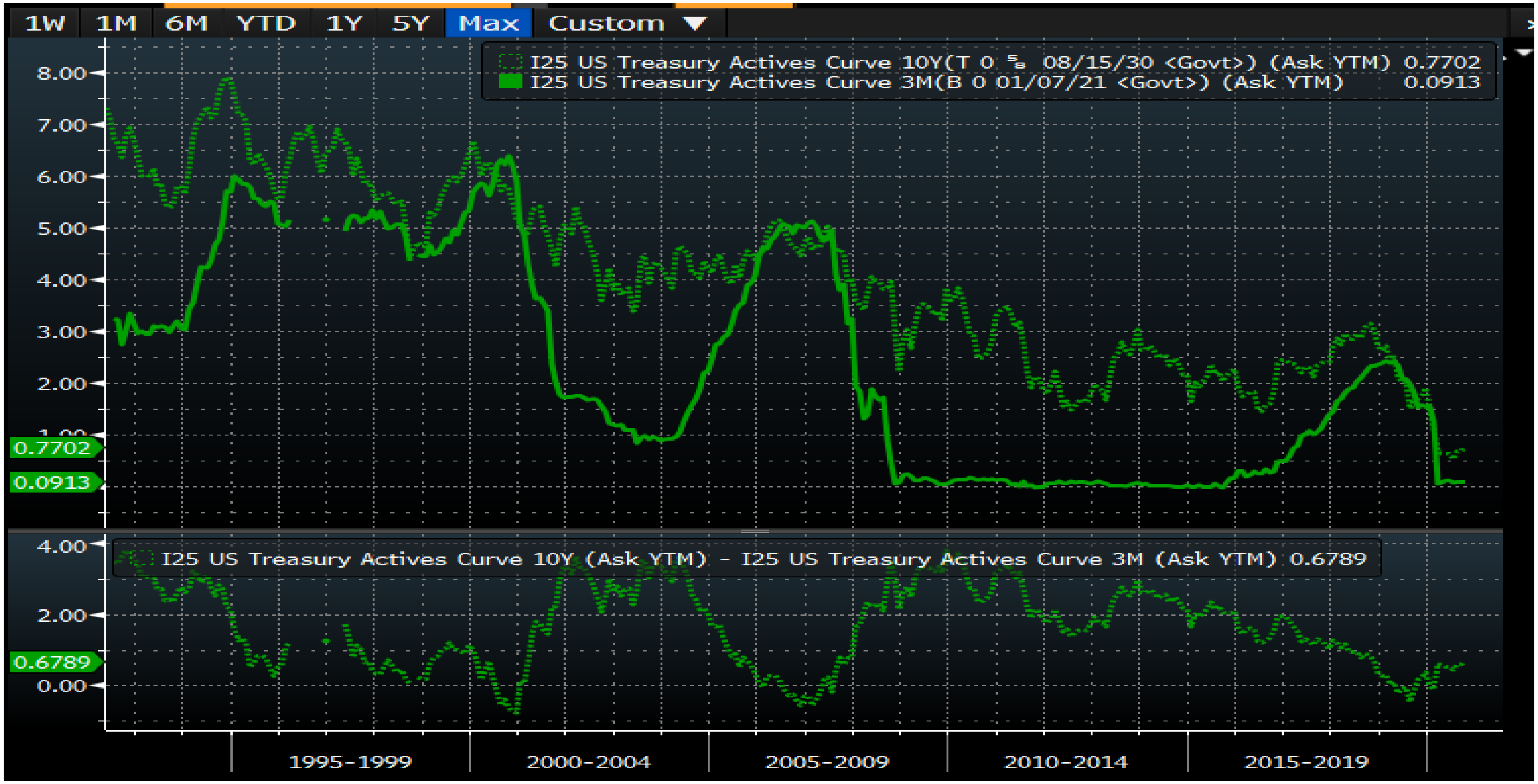
Source: Bloomberg

Yield Curve Changes: 1 Year Ago…



Source: Bloomberg

Historical View of 3mo & 10yr UST: 1992-2020



© 2020 Performance Trust. All Rights Reserved. *Source: Bloomberg*

20-Year AAA Muni Spread to 7-Yr UST: Jan 2019 - Current

Source: Bloomberg

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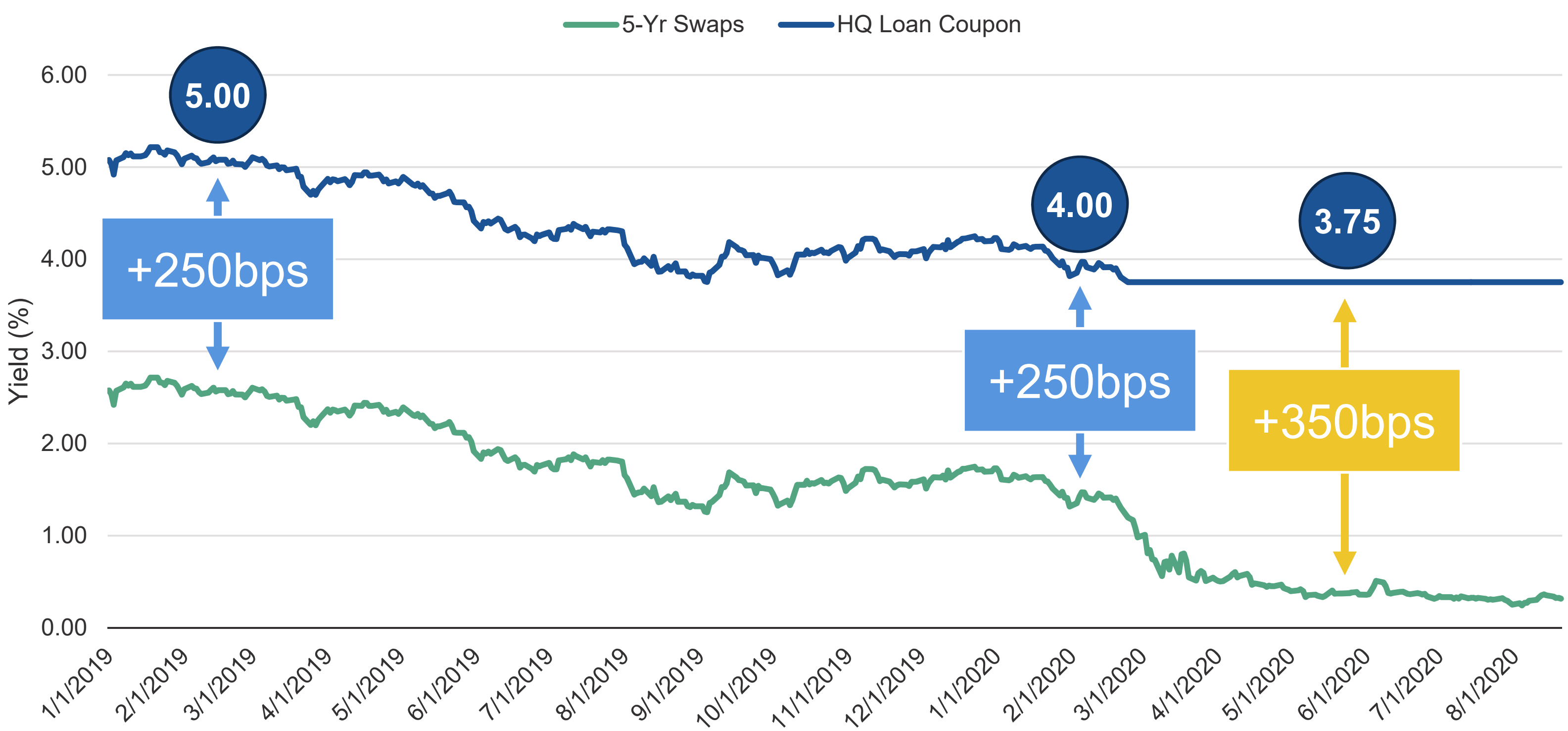
High Quality Loan Spreads to 5-Yr Swaps: Jan 2019 – Current



Source: Bloomberg

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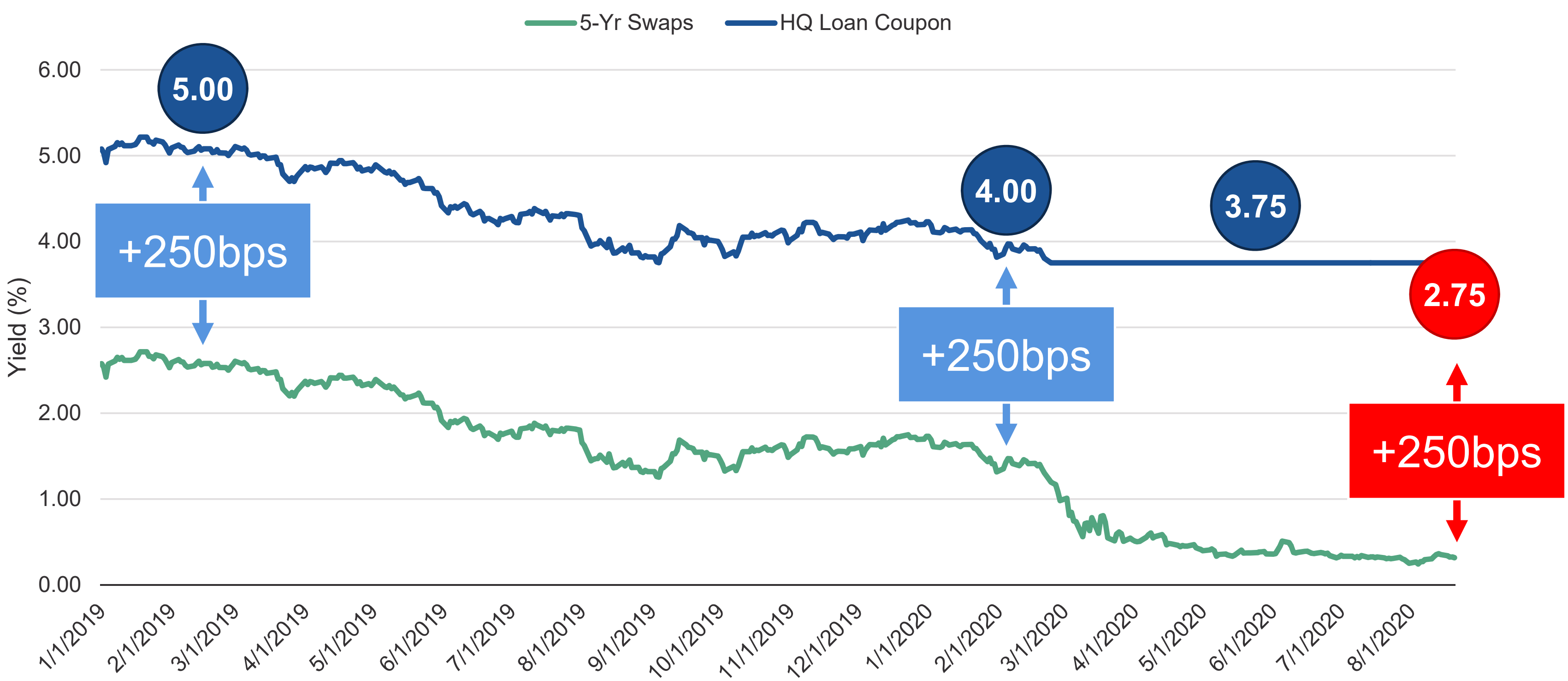
High Quality Loan Spreads to 5-Yr Swaps: Jan 2019 – Current



Source: Bloomberg

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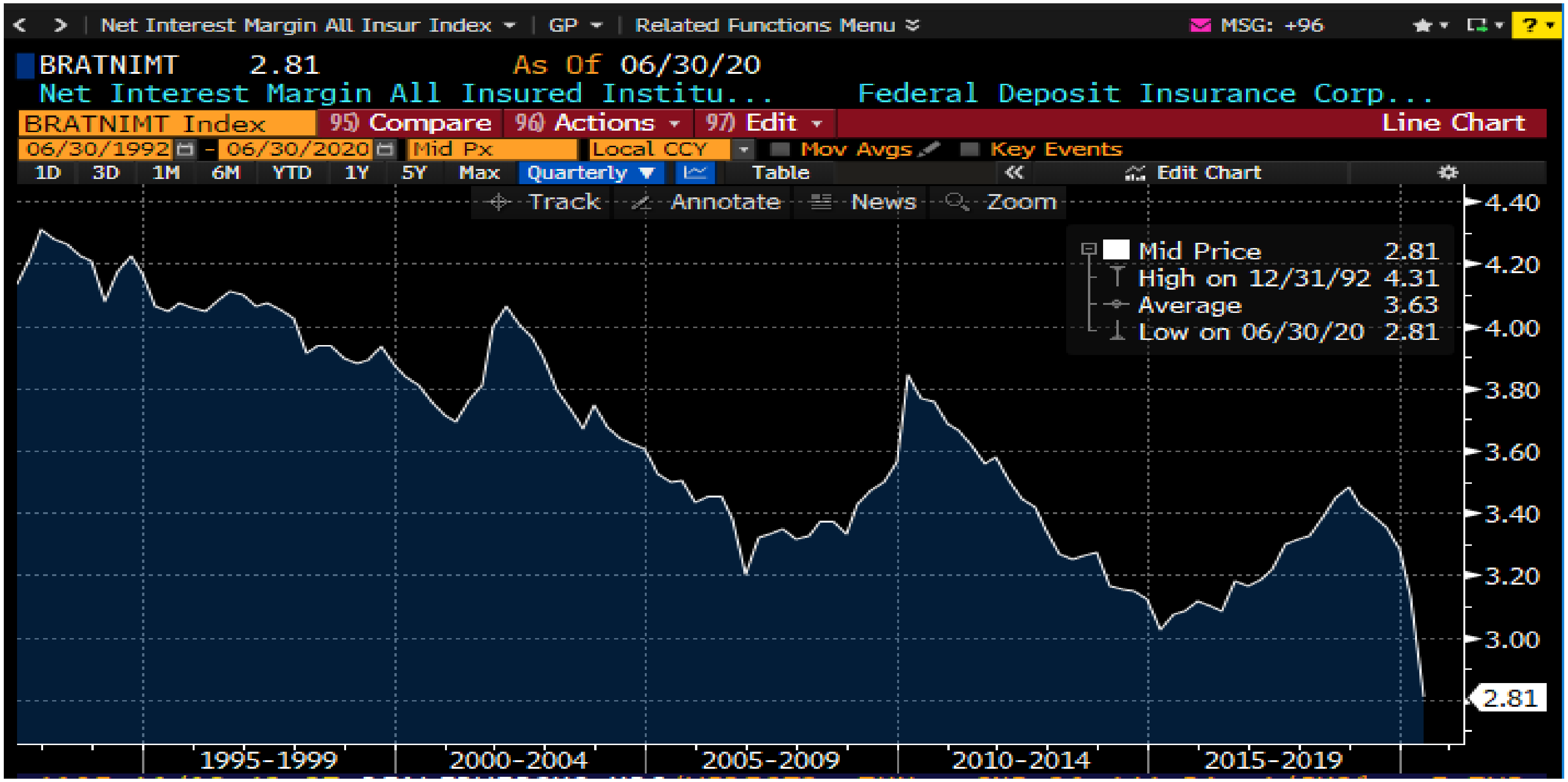
Historical View of FDIC Bank NIM 1992-2020



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Source: Bloomberg

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Polling Question #2

What best describes your institution's ALM position, over a 2+year outlook?

- Yes, we are very asset sensitive
- Yes, we are somewhat asset sensitive
- We have a neutral balance sheet profile
- No, we are liability sensitive

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What Do The Best Investors And Best Businesses Care About?

- A ***high performing franchise*** is led by a collective team that can take time to measure and quantify the IRR of the strategy, while looking at the aggregate risk vs. reward over time, and act on those decisions with clarity and confidence.

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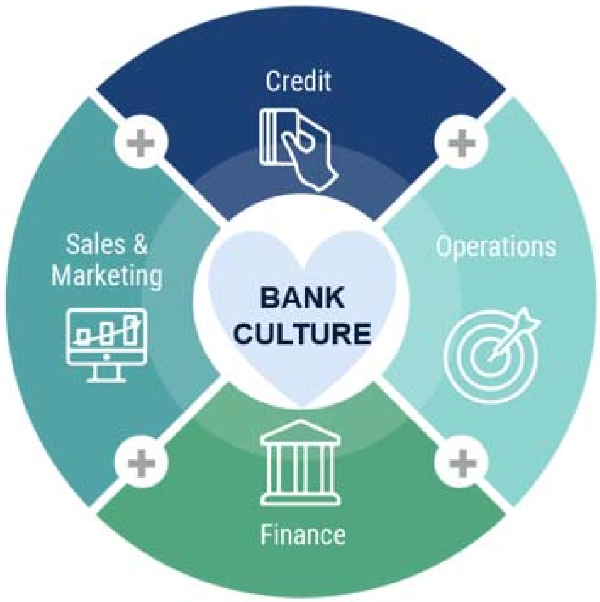
Strong Institution + Regulatory Good Standing Over Time



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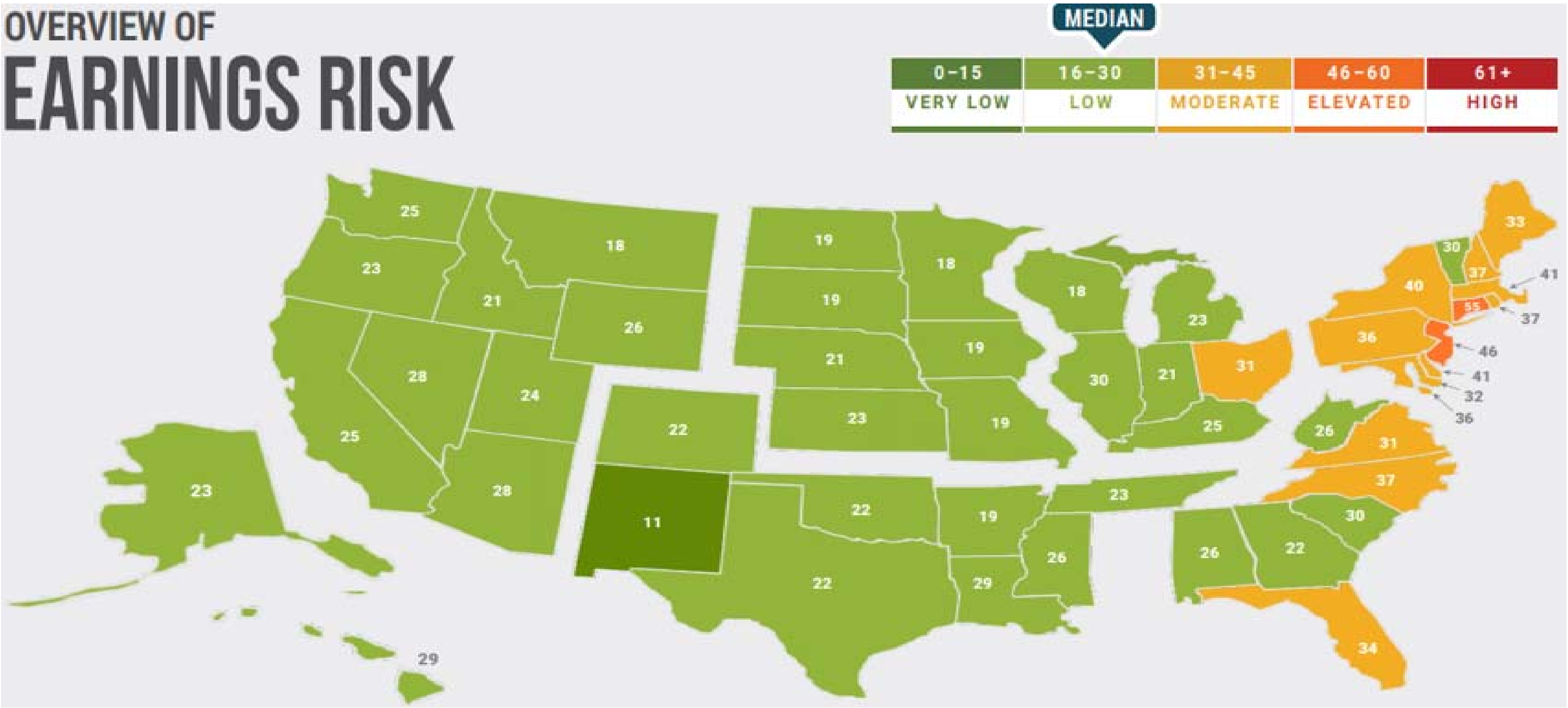
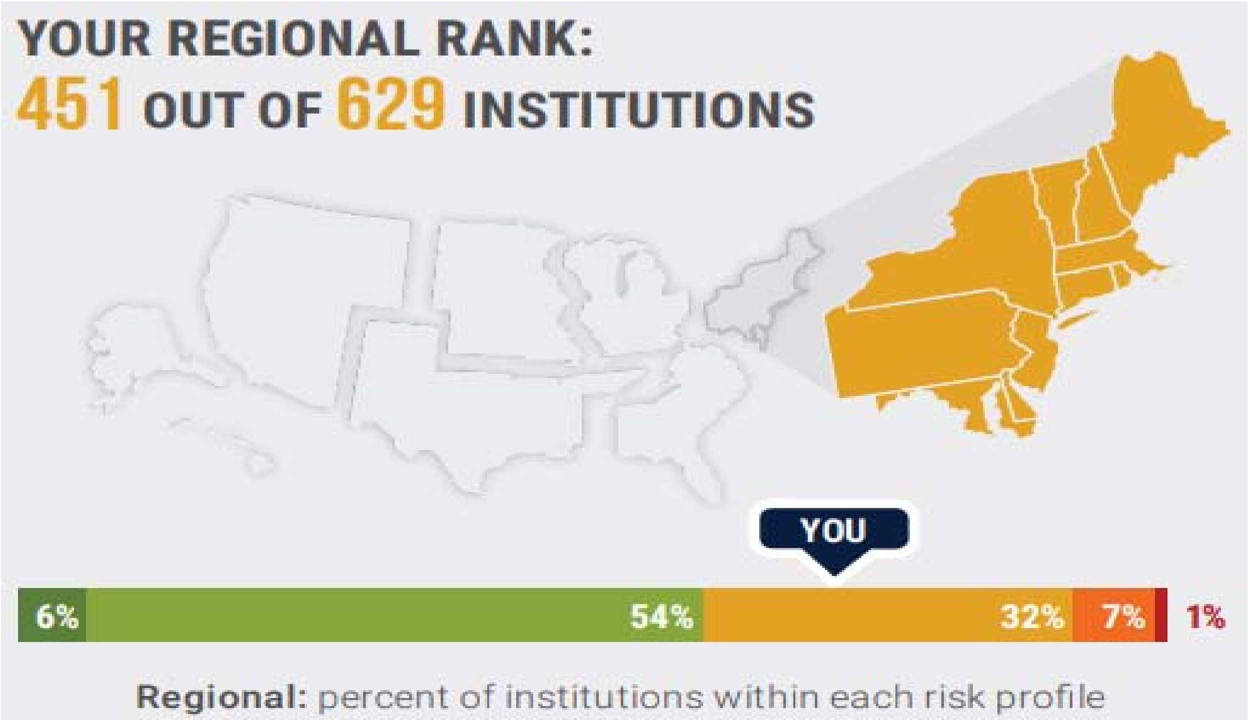
National & Regional Earnings Risk Overview 2020 Q2



Source: PT Score

Where Do You Stand vs. Your Peers?



Source: PT Score

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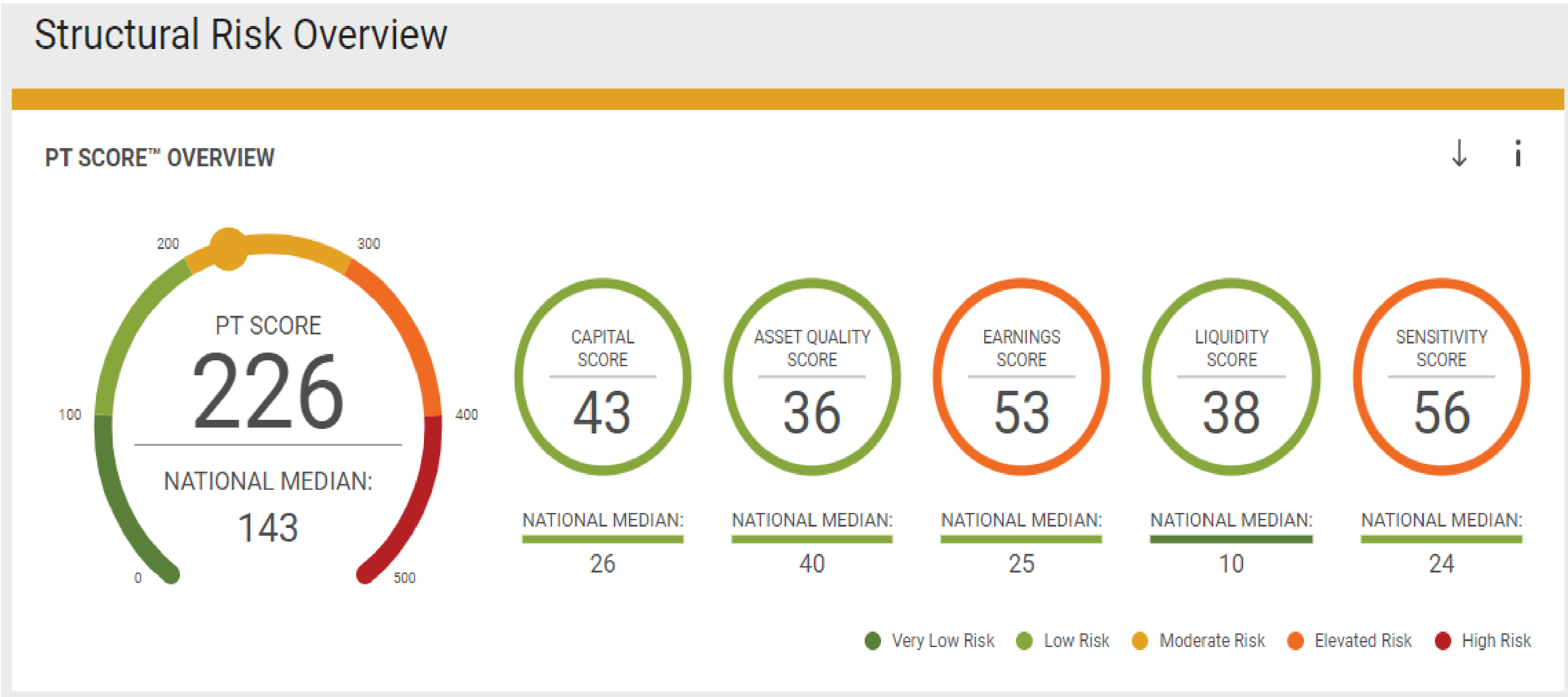
Q2 2020 KRIS



Source: PT Score

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PT Score™ Rankings Over Time

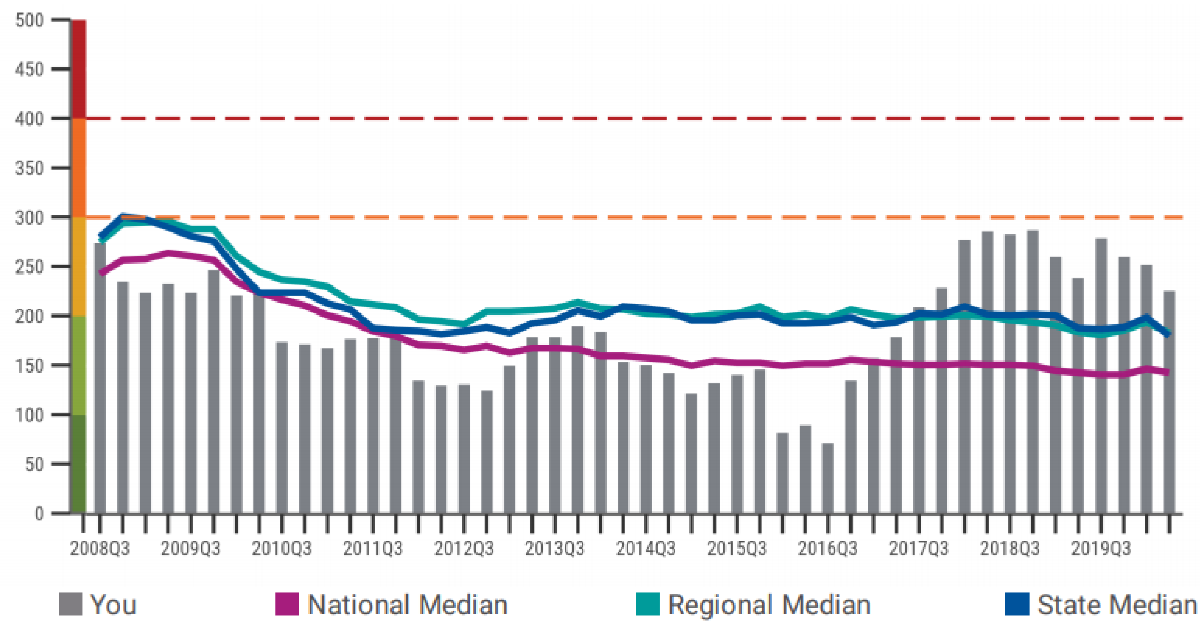
Executive Summary—What Does This Score Mean for Your Institution?

Your score shows your institution is performing at the risk level of:

MODERATE

Institutions with this risk profile are generally satisfactory; however, increased risk positions could make these institutions more vulnerable to decline during stressed conditions.

YOUR INSTITUTION'S PT SCORE® OVER TIME



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Source: PT Score

Risk Position Today & Under Stress – Capital Burn-Down Scenario

226 Your Pre-Stress PT Score®

RESULTS OF STRESS SCENARIOS ON YOUR PT SCORE®

	10-Year Factor	5-Year Factor	2-Year Factor
National Stress	321	233	233
Regional Stress	253	233	233
Individual Stress	233	233	233

Estimated Details of National Stress Impacts

YOUR RESULTS WITH STRESS AT THE NATIONAL LEVEL

NATIONAL STRESS IMPACT ON YOUR T1 LEVERAGE RATIO

7.44%	10-Year Factor
9.89%	5-Year Factor
10.20%	2-Year Factor

Source: PT Score

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Actual Q2 2020

MRQ			
	Avg. Balance		
Total Assets	$ 630,000		
Earnings Assets	$ 580,000		
Equity	$ 78,638		
	Avg. Balance	Yield	$ Annualized
Cash	$ 26,930	0.31%	$ 83
Bonds	$ 53,235	2.32%	$ 1,236
Loans	$ 502,539	3.82%	$ 19,197
Interest Income		3.26%	$ 20,516
Interest Expense		0.59%	$ (3,717)
NIM		2.90%	$ 16,799
Non Int Income		0.92%	$ 5,796
Non Int Expense		2.93%	$ (18,459)
Net Overhead		-2.01%	$ (12,663)
Pre Tax Pre Provision NI		0.66%	$ 4,136
Provision Expense		0.32%	$ (1,604)
Post Tax Net Income			$ 1,993
ROA - Bank			0.32%
ROE - Bank			2.53%

Rates Unchanged

2023 Projections - Sustained "New Normal"			
	Avg. Balance		
Total Assets	$ 650,000		
Earnings Assets	$ 600,000		
Equity	$ 84,158		
	Avg. Balance	Yield	$$
Cash	$ 64,159	0.10%	$ 64
Bonds	$ 52,784	1.50%	$ 792
Loans	$ 501,647	3.00%	$ 15,049
Interest Income		2.45%	$ 15,905
Interest Expense		0.30%	$ (1,698)
NIM		2.37%	$ 14,208
Non Int Income		0.93%	$ 6,045
Non Int Expense		2.93%	$ (19,045)
Net Overhead		-2.00%	$ (13,000)
Pre Tax Pre Provision NI		0.19%	$ 1,208
Provision Expense / Loans		0.32%	$ (1,605)
Post Tax Net Income	21.00%		$ (314)
ROA			-0.05%
ROE			-0.37%

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Actual Q2 2020

MRQ			
	Avg. Balance		
Total Assets	$ 630,000		
Earnings Assets	$ 580,000		
Equity	$ 78,638		
	Avg. Balance	*Yield*	*$ Annualized*
Cash	$ 26,930	0.31%	$ 83
Bonds	$ 53,235	2.32%	$ 1,236
Loans	$ 502,539	3.82%	$ 19,197
Interest Income		**3.26%**	**$ 20,516**
Interest Expense		**0.59%**	**$ (3,717)**
NIM		**2.90%**	**$ 16,799**
Non Int Income		0.92%	$ 5,796
Non Int Expense		2.93%	$ (18,459)
Net Overhead		**-2.01%**	**$ (12,663)**
Pre Tax Pre Provision NI		**0.66%**	**$ 4,136**
Provision Expense		0.32%	$ (1,604)
Post Tax Net Income			**$ 1,993**
ROA - Bank			**0.32%**
ROE - Bank			**2.53%**

Rates Up 100

2023 Projections - Rates Up 100			
	Avg. Balance		
Total Assets	$ 650,000		
Earnings Assets	$ 600,000		
Equity	$ 84,158		
	Avg. Balance	*Yield*	*$$*
Cash	$ 64,159	1.10%	$ 706
Bonds	$ 52,784	2.75%	$ 1,452
Loans	$ 501,647	4.25%	$ 21,320
Interest Income		**3.61%**	**$ 23,477**
Interest Expense		**0.60%**	**$ (3,395)**
NIM		**3.35%**	**$ 20,082**
Non Int Income		0.93%	$ 6,045
Non Int Expense		2.93%	$ (19,045)
Net Overhead		**-2.00%**	**$ (13,000)**
Pre Tax Pre Provision NI		**1.09%**	**$ 7,082**
Provision Expense / Loans		0.12%	$ (602)
Post Tax Net Income	21.00%		**$ 5,119**
ROA			**0.79%**
ROE			**6.08%**

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Polling Results

SHOW RESULTS FROM POLL QUESTION #2 HERE

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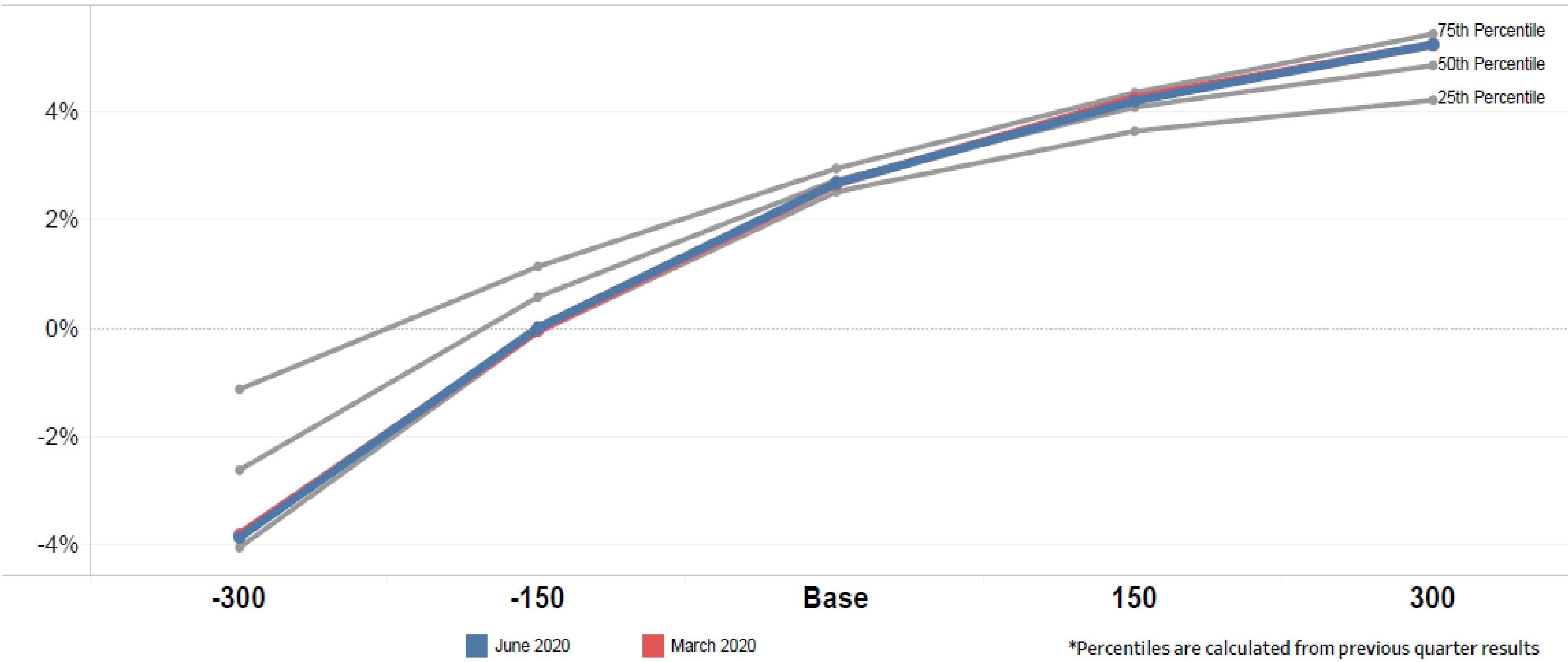
Asset-Sensitive Institution Profile – 3yr Outlook

3 - Year Total Return Peer Comparison



*Percentiles are calculated from previous quarter results

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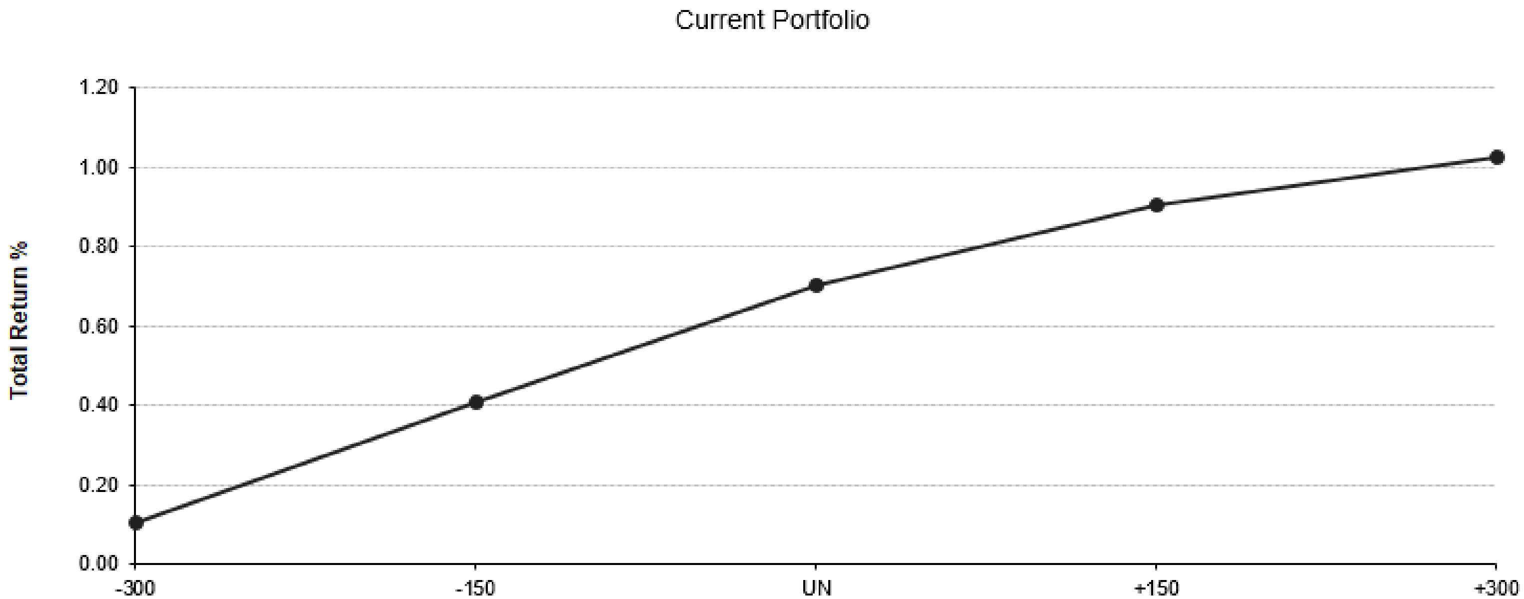
Securities Portfolio 3yr Outlook:

3-Year Total Return



Rate Scenarios	-300	-150	UN	+150	+300
Current Portfolio	0.11	0.41	0.70	0.90	1.02

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Polling Question #3

Does your institution have above-normal levels of on-balance sheet liquidity, as compared to the last 5 year average?

- Yes
- No

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"The question is not what you look at – but how you look and whether you see."

Henry David Thoreau

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Sensitivity To Market Risk:

"Deterministic modeling techniques allow management to specify the direction, amount, and timing of future interest rates in order to measure the potential impact the changes may have on earnings and capital."

Source: RMS Manual of Examination Policies 7.1-21
Sensitivity to Market Risk (7/18)
Federal Deposit Insurance Corporation

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Four Main Risks To Every Balance Sheet's Cash Flow

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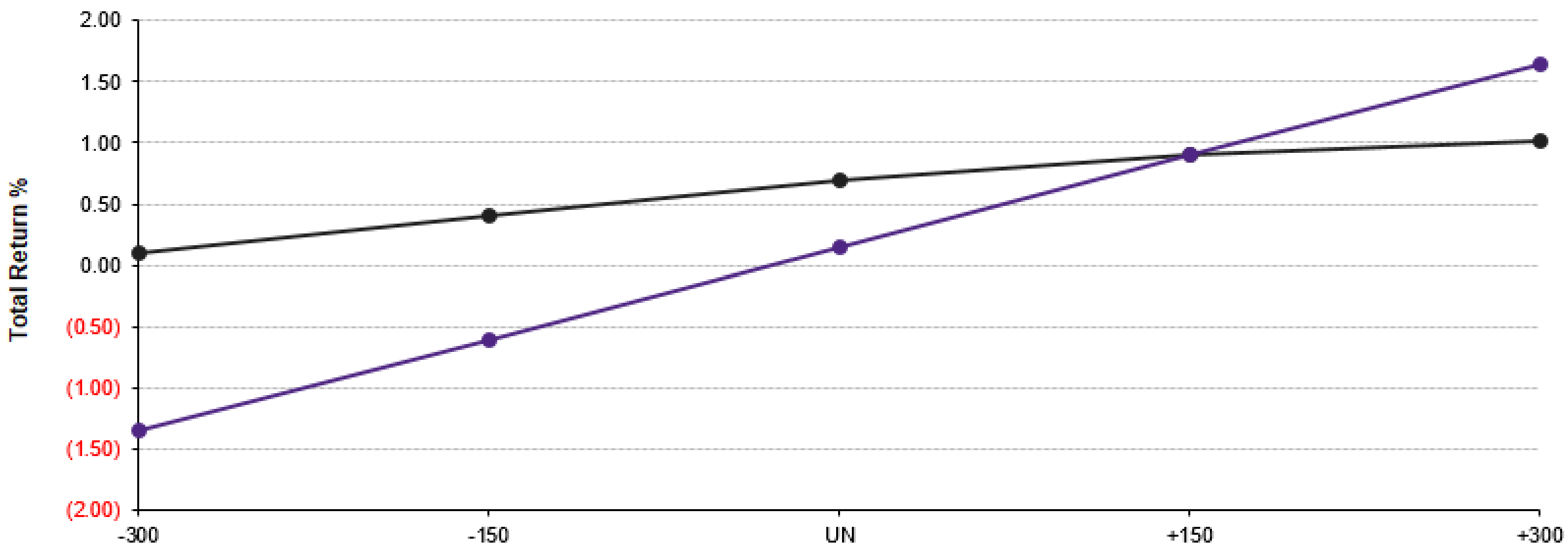
Multi Scenario Analysis, Over Time, is PARAMOUNT

3-Year Total Return



Rate Scenarios	-300	-150	UN	+150	+300
Current Portfolio	0.11	0.41	0.70	0.90	1.02
LPF FedFunds	(1.35)	(0.60)	0.15	0.90	1.65

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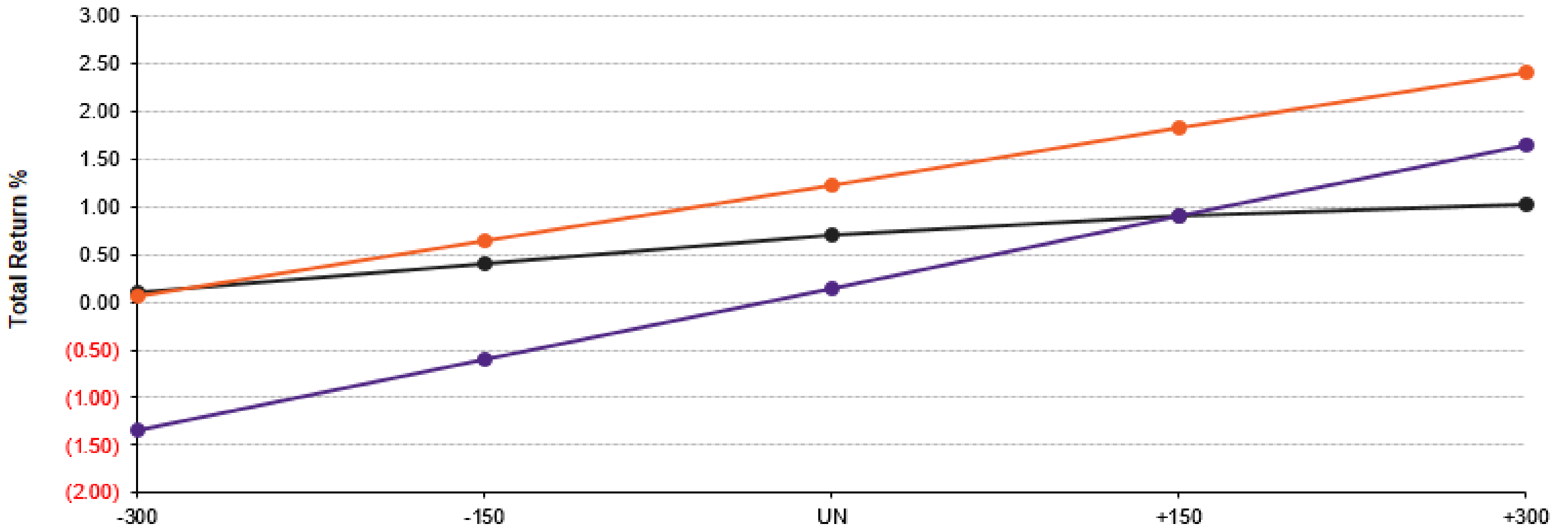
Rates-Up Defense: Agency Mortgage-Backed Pool

3-Year Total Return



Rate Scenarios	-300	-150	UN	+150	+300
Current Portfolio	0.11	0.41	0.70	0.90	1.02
LPF FedFunds	(1.35)	(0.60)	0.15	0.90	1.65
LPF Agency Backed Insulator	0.07	0.64	1.22	1.82	2.42

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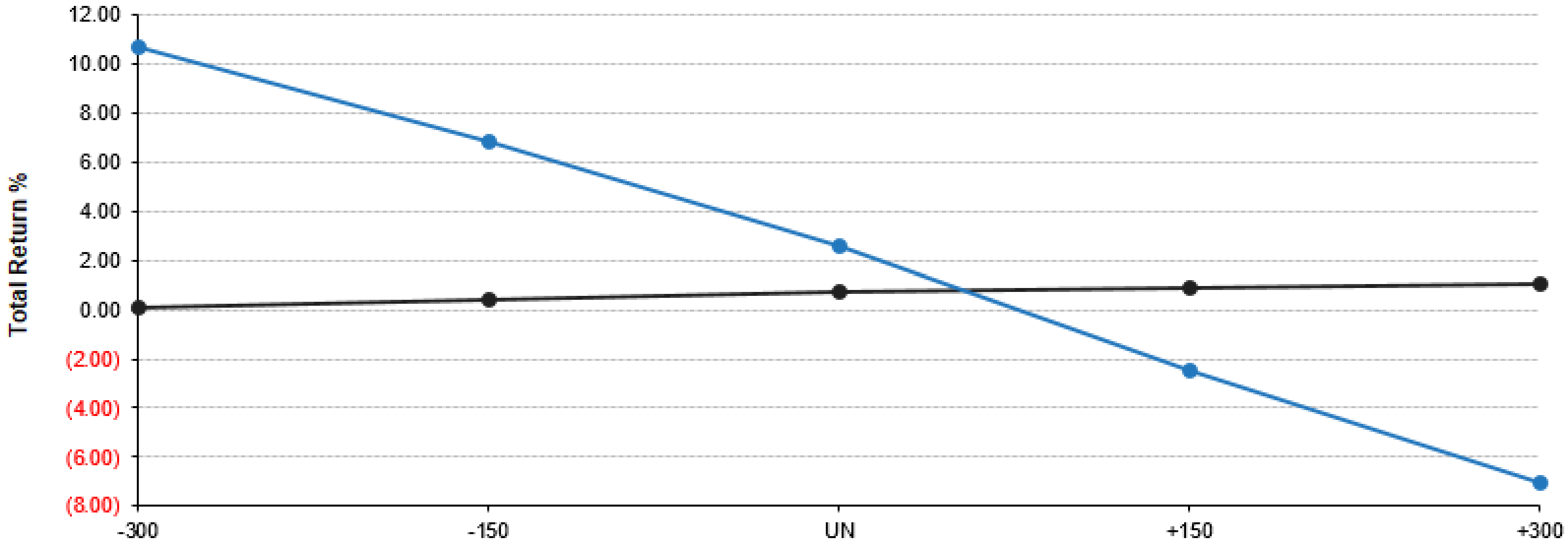
Rates Down Defense: High Quality, Call-Protected, G.O. Muni

3-Year Total Return



Rate Scenarios	-300	-150	UN	+150	+300
Current Portfolio	0.11	0.41	0.70	0.90	1.02
LPF Muni Taxable 15NC10	10.67	6.87	2.54	(2.45)	(7.05)

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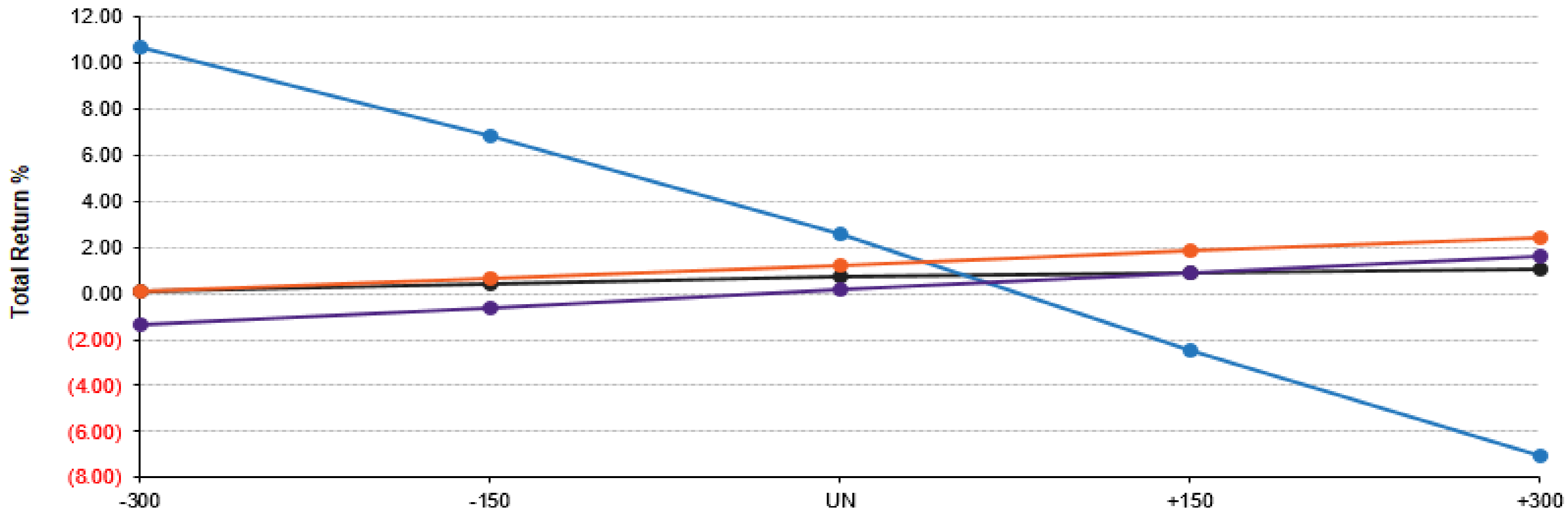
20% Risk-Weight to Capital Assets, vs. Cash, vs. Current Securities Portfolio

3-Year Total Return



Rate Scenarios	-300	-150	UN	+150	+300
Current Portfolio	0.11	0.41	0.70	0.90	1.02
LPF Muni Taxable 15NC10	10.67	6.87	2.54	(2.45)	(7.05)
LPF FedFunds	(1.35)	(0.60)	0.15	0.90	1.65
LPF Agency Backed Insulator	0.07	0.64	1.22	1.82	2.42

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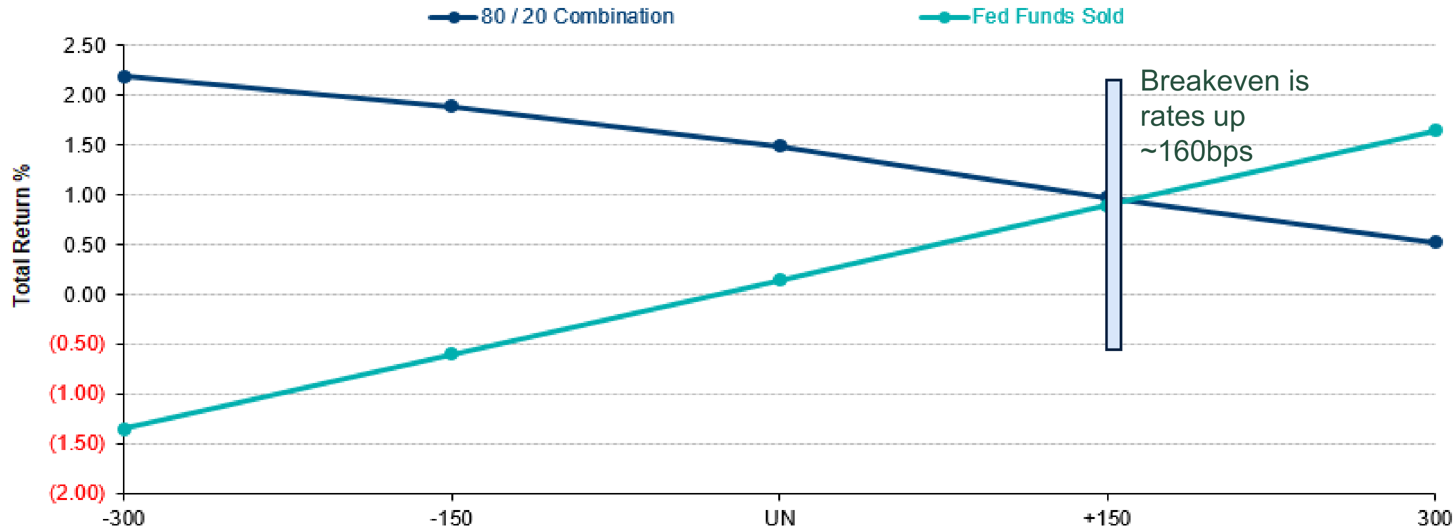
Barbell Combination: Short, Agency-Backed MBS + High-grade GO Unlimited Txbl Munis

3-Year Total Return



Combo A/B	-300	-150	UN	+150	300	wgt
LPF AgyCMO Insulator 1y	0.07	0.64	1.22	1.82	2.42	80%
LPF Muni Taxable 15NC10	10.67	6.87	2.54	(2.45)	(7.05)	20%
LPF FedFunds	(1.35)	(0.60)	0.15	0.90	1.65	100%
80 / 20 Combination	2.19	1.89	1.49	0.97	0.52	100%
Fed Funds Sold	(1.35)	(0.60)	0.15	0.90	1.65	100%
Difference	**3.54**	**2.49**	**1.34**	**0.07**	**(1.12)**	

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A Case for Measuring Risk vs. Reward

- *Hedge the other portions of the balance sheet, creatively managing liabilities, reducing optionality, adding durable income while preserving capital.*
- *Add call protected cashflow that price off of higher slope on yield curve, at spreads wider than historical averages, and mix of credits that diversify assets for interest-rate neutral positioning.*
- *Diversify against unwanted re-pricing risk which compress NIM over time.*
- *Take time to look back on past decisions, measuring the performance of the decision over time.*
- *Continue to be proactive while maintaining weekly/monthly monitoring of credit and interest rate risks across entire balance sheet.*

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Polling Question #4

Related to borrower credit, is the sentiment we are already past the worst or will there be continued strain ahead?

- We will see things get better soon
- Somewhat neutral, we have plateaued and will stay here for a while
- We have seen the worst as of yet

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A Case for Measuring Risk vs. Reward

I believe strong institutions will meaningfully increase their foothold in a competitive market while remaining independent by adding quality, sustainable earnings through time with regulatory good standing.

- Consideration for any balance sheet strategy, no matter what the size or scope, must include:
  - *Structure and price of a decision –*
    - ***Will it result in EPS Accretion or growth in ROE?***
    - ***Is this capturing an acceptable amount of reward for the risk?***
    - ***What is my ROI now, across multiple rate scenarios, and over time?***
- Always including the *balance sheet strategy* and *mission* of the organization to every decision, while counting the dollars over time and different rate environments, will allow for better clarity and confidence, as you continue remain the heartbeat of the community.

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Your balance sheet is the sum of all the decisions that you have made in the past, your **future** is the sum of **all future decisions** that have yet to be made

— Adopted from Myles Munroe

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