

# Financial Regulator Responses to COVID-19

March 23, 2020

During the week of March 15, the Federal Reserve Board (the “FRB”), the Federal Deposit Insurance Corporation (“FDIC”) and the Office of the Comptroller of the Currency (collectively, the “Agencies”) took emergency measures in response to the economic and market disruptions related to the Coronavirus Disease 2019 (COVID-19). These actions are summarized below.

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## Monetary Policy

### Target Rate and Open Market Operations

On March 15, the Federal Open Market Committee (“FOMC”) lowered the federal funds rate target range to 0 to 0.25%. In connection with the revised target range, the FOMC directed the Open Market Desk to increase holdings in the System Open Market Account of Treasury securities and agency mortgage-backed securities by at least \$500 billion and \$200 billion, respectively, to begin conducting overnight reverse repurchase operations at an offering rate of 0% (subject to a per-counterparty limit of \$30 billion per day) and to engage in dollar roll and coupon swap transactions “as necessary” to settle its agency mortgage-backed securities transactions.

The FOMC also indicated that it would reinvest all principal payments from its holdings of agency debt and agency mortgage-backed securities back into agency mortgage-backed securities and significantly expand its overnight and term repo operations.

A link to the FRB press release announcing the FOMC statement may be found [here](#).

### Discount Window

The FRB lowered the primary credit rate of its discount window from 1.75% to .25%, and expanded the scope of the discount window to permit borrowing of up to 90 days, repayable and renewable by the borrower on a daily basis, effective on March 16, 2020. Previously, discount window lending was only available on an overnight basis.

The expansion of the discount window to permit term lending, repayable and renewable without penalty, effectively allows banks to secure overnight funding that is treated favorably under the Agencies' liquidity coverage ratio ("LCR") (and could allow banking organizations to use the discount window by "upgrading" collateral (*i.e.*, pledged to the discount window) into high-quality liquid assets).<sup>1</sup>

Links to FRB press releases discussing the change may be found [here](#), [here](#) and [here](#).

### **Interest on Reserves and Reserve Requirements**

The FRB lowered the interest rates paid on required and excess reserve balances from 1.1% to 0.1%, effective March 16, 2020. In addition, the FRB lowered the required reserve ratio against net transaction accounts in and above the low reserve tranche to 0% (from 3% and 10%, respectively) effective for the reserve maintenance period beginning March 26, 2020. The FRB estimated that the reduction in reserve requirements actions will reduce required reserves by an estimated \$200 billion. This reduction is consistent with the FOMC's announcement in 2019 that it would continue to implement monetary policy in an "ample reserves regime" (in contrast to the pre-crisis, "scarce reserves" regime), in which minimum reserve requirements do not play a significant role in implementing monetary policy.

Links to FRB press releases discussing the change may be found [here](#) and [here](#).

### **Coordinated Central Bank Action to Support U.S. Dollar Liquidity**

On March 15, the Federal Reserve, Bank of Canada, Bank of England, Bank of Japan, European Central Bank and Swiss National Bank announced that they would lower the pricing on U.S. dollar swap lines by 25 basis points, to the U.S. dollar overnight index swap ("OIS") rate plus 25 basis points. These swap lines, which are authorized under Section 14 of the Federal Reserve Act, allow the FRB to indirectly improve liquidity conditions in the substantial overseas dollar funding markets by providing foreign central banks with the ability to provide U.S. dollar funding to institutions in their respective jurisdictions.

In connection with the decrease in rates, foreign central banks also agreed to offer U.S. dollars weekly in their respective jurisdictions with an 84-day maturity, in addition to the one-week maturity operations currently offered, the latter of which the foreign

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<sup>1</sup> As explained in the Agencies' "Q&As on Statement Regarding the Use of Capital and Liquidity Buffers," longer-term borrowing receives favorable treatment under the Agencies' liquidity cover ratio rule. In particular, wholesale borrowing with a residual maturity of more than 30 days is not considered to be a cash outflow. 12 CFR 249.32. Although 90-day term funding that is repayable within 30 days ordinarily is considered to have a maturity of 30 days or less, the banking organization may opt instead to use the original maturity at issuance if the counterparty is a sovereign entity, including a Federal Reserve Bank. See 12 CFR 249.31(a)(1)(iii)(B).

central banks announced on March 20 that they would begin to conduct daily (as opposed to weekly) beginning on March 23.

Subsequently on March 16, the FRB announced the establishment of temporary U.S. dollar swap lines with the Reserve Bank of Australia, the Banco Central do Brasil, the Danmarks Nationalbank (Denmark), the Bank of Korea, the Banco de Mexico, the Norges Bank (Norway), the Reserve Bank of New Zealand, the Monetary Authority of Singapore, and the Sveriges Riksbank (Sweden).

Links to FRB press releases discussing the changes may be found [here](#), [here](#) and [here](#).

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## Emergency Funding Facilities

During the week, the FRB established a number of emergency funding facilities to stabilize the markets pursuant to its authority under Section 13(3) of the Federal Reserve Act, with the approval of the Treasury Secretary. Key terms of each of the facility are highlighted below.

### Commercial Paper Funding Facility

- **Structure.** A credit facility (with recourse) extended by the Federal Reserve Bank of New York (the “[FRBNY](#)”) to a special purpose vehicle (“[SPV](#)”) established to purchase commercial paper directly from eligible issuers. The U.S. Treasury will provide \$10 billion of credit protection from the Exchange Stabilization Fund to the FRBNY to backstop the facility.
- **Eligible Participants.** U.S. issuers of commercial paper, including U.S. issuers with a foreign parent company.
- **Eligible Assets/Collateral.** Investment grade commercial paper (“[CP](#)”).<sup>2</sup>
- **Pricing.** Based on then-current three-month OIS rate plus 2% (200 basis points).
- **Other Terms.** Eligible issuers must register prior to participating, and must pay a one-time facility fee equal to 0.1% (10 basis points) of the maximum amount of CP that the SPV may own. A link to the term sheet may be found [here](#).

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<sup>2</sup> Must be rated at least A-1/P-1/F-1 by a major nationally recognized statistical rating organization (“NRSRO”), and if rated by multiple NRSROs, rated at least A-1/P-1/F-1 by two or more major NRSROs. In addition, the SPV may make one-time purchases from issuers that meet these criteria as of March 17, 2020 and were rated at least A-2/P-2/F-2 as of the purchase dates.

## Primary Dealer Credit Facility

- Structure. A secured credit facility (with recourse) extended by the FRBNY to primary dealers.
- Eligible Participants. Primary dealers.
- Eligible Assets/Collateral. Any collateral eligible for pledge in FRBNY open market operations, as well as investment grade corporate debt securities, international agency securities, CP, municipal securities, mortgage-backed securities, certain asset-backed securities,<sup>3</sup> and certain equity securities.<sup>4</sup> Pledged collateral will be valued by the Bank of New York Mellon according to a schedule similar to the margin schedule under the discount window.
- Pricing. Primary credit rate.
- Other Terms. Loans may be made available for a term of up to 90 days, repayable at any time. The term nature and repayment provides same favorable LCR treatment as discount window borrowing. A link to the term sheet may be found [here](#).

## Money Market Fund Liquidity Facility

- Structure. A secured (non-recourse) credit facility extended by the Federal Reserve Bank of Boston (“FRBB”) to provide liquidity to money market mutual funds. The U.S. Treasury will provide \$10 billion of credit protection from the Exchange Stabilization Fund to the FRBB to backstop the facility.
- Eligible Participants. U.S. depository institutions, top-tier U.S. bank holding companies and their U.S. broker-dealer subsidiaries, and U.S. branches and agencies of foreign banks.
- Eligible Assets/Collateral. U.S. Treasury and fully guaranteed agency securities (e.g., Ginnie Mae), securities issued by U.S. government sponsored enterprises (e.g., Fannie Mae and Freddie Mac) valued at amortized cost or fair value. Also includes certain investment grade asset-backed CP,<sup>5</sup> certain unsecured CP,<sup>6</sup> certain U.S. municipal

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<sup>3</sup> Commercial mortgage-backed securities, collateralized loan obligations and collateralized debt obligations must be AAA-rated. Commercial paper must be rated A1/P1 or A2/P2.

<sup>4</sup> Exchange-traded funds, unit investment trusts, mutual funds, rights and warrants will not be eligible.

<sup>5</sup> At the time of purchase from the money market mutual fund or pledge to the FRBB, must be rated not lower than A1, F1 or P1 by at least two major rating agencies or, if rated by only one major rating agency, then rated within the top rating category by that agency.

<sup>6</sup> *Id.*

short-term debt<sup>7</sup> and certain receivables from repurchase agreements valued at amortized cost. The assets must be purchased concurrently with the borrowing, or on or after March 18, 2020 but before the opening of the facility, from a prime, single state or other tax exempt money market fund (identified as such under item A.10 of SEC Form N-MFP).

- **Pricing.** Loans secured by U.S. Treasuries and fully guaranteed agencies or by U.S. government sponsored entities will be made at the primary credit rate. Loans secured by U.S. municipal short-term debt will be made at the primary credit rate plus .25% (25 basis points). All other loans will be made at the primary credit rate plus 1% (100 basis points).
- **Other Terms.** The maturity date of each advance will be the maturity date of the eligible collateral pledged to secure the advance made under the facility subject to a ceiling of 12 months. Therefore, borrowings secured by pledges of collateral with a residual maturity of longer than 30 days may have favorable LCR treatment (until residual maturity reaches 30 days or less).<sup>8</sup> A link to the term sheet may be found [here](#).

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## Regulatory Capital Relief

During the week, the Agencies issued two interim final rules that seek to provide regulatory capital relief as banking organizations.

### Eligible Retained Income

The Agencies modified the definition of “eligible retained income” for purposes of the capital conservation buffer (“**CCB**”)<sup>9</sup> to provide a more gradual phase-in of limitations on capital distributions and discretionary bonus payments based on a banking

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<sup>7</sup> Must have a maturity that does not exceed 12 months and at the time of purchase from the money market mutual fund or pledge to the FRBB: (1) if rated in the short-term rating category, is rated in the top short-term rating category (e.g., SP1, MIG1, or F1) by at least two major rating agencies or if rated by only one major rating agency, then rated within the top rating category by that agency; or (2) if not rated in the short-term category, then rated in the top long-term rating category (AA or above) by at least two major rating agencies or, if rated by only one major rating agency, is rated within the top rating category by that agency.

<sup>8</sup> If the FRB clarifies that the advances may be repaid at any time, the bank may opt instead to use the original maturity throughout the term of the borrowing, as with discount window borrowing. See 12 CFR 249.31(a)(1)(iii)(B).

<sup>9</sup> If a banking organization’s capital conservation buffer falls below 2.5% plus any required countercyclical capital buffer (“**CCyB**”) and global systemically important bank holding company (“**GSIB**”) surcharge, the firm becomes subject to increasingly stringent limitations on capital distributions and certain discretionary bonus payments.

organization's historical level of distributions.<sup>10</sup> In contrast, under the current framework, a banking organization that has had positive net income over the past calendar year, but has distributed a large portion of those earnings to shareholders, could be severely restricted in its ability to pay distributions if its CCB fell below 2.5% plus any required CCyB and GSIB surcharge (because the distributions during good quarters would reduce eligible retained income during bad quarters). This revision is “intended to strengthen the incentives for a banking organization to use its capital buffers as intended in adverse conditions and serve as a financial intermediary and source of credit to the economy.”

A link to a prior Debevoise In Depth discussing the interim final rule may be found [here](#).

### Capital Relief Related to MMLF

Under the Agencies' current regulatory capital rules, a banking organization that purchases assets from one party and pledges them to another party would be required to hold risk-based and leverage capital against the purchased assets, because the assets come onto the banking organization's balance sheet (and the pledge does not take them off balance sheet). Pursuant to an interim final published concurrently with the announcement of the establishment of the Money Market Fund Liquidity Facility, the Agencies allowed banking organizations to neutralize the regulatory capital effects of participation in that facility by excluding any exposures acquired and pledged to the Money Market Fund Liquidity Facility from total leverage exposure, average total consolidated assets, advanced approaches total risk-weighted assets, and standardized total risk-weighted assets.<sup>11</sup>

A link to the interim final rule may be found [here](#).

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## Agency Statements

This past week, the Agencies also issued a number of press releases and other statements.

### Statement on the Use of Capital and Liquidity Buffers and Related Q&A

In a statement accompanying the interim final rule modifying the definition of “eligible retained income,” the Agencies explicitly encouraged banking organizations to use their

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<sup>10</sup> In particular, the definition is revised to be the greater of: (1) net income for the four calendar quarters preceding the current calendar quarter, net of any distributions and associated tax effects not already reflected in net income (*i.e.*, the current definition); and (2) the average of net income for the four calendar quarters preceding the current calendar quarter.

<sup>11</sup> The Agencies did not provide similar relief for the Primary Dealer Credit Facility, presumably due to the comparatively wider range of collateral that may be pledged under that facility.

capital and liquidity buffers “as they respond to the challenges presented by the effects of the coronavirus.” In a subsequent Q&A document, the Agencies clarified that, notwithstanding this encouragement, they are not suspending or modifying any of the minimum regulatory requirements. In particular, the Agencies’ responses to FAQs #1 (liquidity buffer), 3 (capital buffer), 4 (resolution planning) and 5 (total loss-absorbing capacity buffers) states that if a banking organization falls below applicable relevant buffer or minimum requirements, then any limitations or requirements that would otherwise apply will continue to apply.

A link to the statement may be found [here](#), and a link to the FAQs may be found [here](#).

### **Joint Statement on CRA Consideration for Activities in Response to COVID-19**

On March 19, 2020, the Agencies published a joint statement on Community Reinvestment Act consideration in recognition of efforts taken to service financial needs of customers in areas affected by COVID-19. For example, the Agencies stated that “prudent efforts” to modify terms on new or existing loans for affected low- and moderate-income customers, small businesses, and small farms will receive CRA consideration and will not be subject to examiner criticism. Similarly, the Agencies stated that firms may also receive CRA consideration for easing terms for new loans to such borrowers, and for community development activities located in a “broader statewide or regional area that includes a bank’s CRA Assessment Area and that help to stabilize communities affected by the COVID-19.”

A link to the statement may be found [here](#).

### **Other Statements**

The Agencies also issued a number of other statements related to COVID-19, including:

- FDIC – Frequently Asked Questions for Financial Institutions Affected by the Coronavirus Disease 2019 (Referred to as COVID-19) (link [here](#)); and
- FFIEC Interagency Statement on Pandemic Planning (Updated) (link [here](#)).

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## **Broker-Dealers and Derivatives Dealers**

During the week, the Securities and Exchange Commission (“[SEC](#)”), Financial Industry Regulatory Authority (“[FINRA](#)”), Commodity Futures Trading Commission (“[CFTC](#)”) and National Futures Association (“[NFA](#)”) issued various forms of relief from reporting

and supervision requirements to facilitate the implementation of business continuity plans providing for the relocation of personnel to remote offices and telecommuting.

### **SEC Relief from CAT Reporting Requirements**

On March 17, 2020, SEC Chairman Jay Clayton issued a public statement announcing that the Division of Trading and Markets has issued temporary relief from implementation of the new consolidated audit trail (“CAT”) reporting requirements, including the planned beginning of transaction reporting in April.<sup>12</sup> Chairman Clayton also announced that the SEC has issued a separate order granting conditional relief from reporting of certain customer data, including (1) social security numbers and tax payer identification numbers for individuals; (2) dates of birth and (3) account numbers.

A link a Debevoise Debrief discussing the relief may be found [here](#).

### **FINRA Regulatory Notice on Business Continuity Planning and Regulatory Relief**

On March 9, 2020, FINRA issued Regulatory Notice 20-08 (the “Notice”) to member firms, updating pandemic preparedness guidance first issued in 2009 and providing specific types of regulatory relief in light of COVID-19. FINRA has temporarily suspended the requirement to maintain updated Form U4s for personnel subject to temporary relocation and has also suspended requirement to register new locations that may qualify as offices as a result of such moves. FINRA has also created a new Coronavirus FAQ page on its website and is periodically updating the page with regulatory guidance.

A link to a prior Debevoise In Depth discussing the Notice may be found [here](#).

A link to the new FINRA webpage may be found [here](#).

### **CFTC No-Action Letters on Oral Communication Records**

On March 17, 2020, the CFTC issued a package of temporary relief to swap dealers and other derivatives market intermediaries through a series of no-action letters. The CFTC determined this temporary relief was necessary to address significant compliance challenges as personnel have been displaced from their normal business offices.

The package, which was accompanied by a NFA notice providing parallel relief, includes CFTC Staff Letter 20-06, which provides relief: (i) until June 30, 2020 from any requirement to make and keep recordings of oral communications pursuant to CFTC regulation 23.202 or record the date and time by time-stamp or other timing device and (ii) from any requirement to furnish an annual chief compliance officer’s report

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<sup>12</sup> A link to the SEC



pursuant to CFTC regulation 3.3 prior to September 1, 2020, permitting such reports to be submitted with a delay of up to 30 days.

A link to a Debevoise Debrief discussing the letters may be found [here](#).

### **CFTC Extension of Compliance Date for Swap Initial Margin Requirements for Smaller Financial End Users**

On March 18, the CFTC also adopted its previously proposed one-year extension of the initial margin compliance deadline for swap dealers transacting with financial end users with relatively small uncleared swap portfolios (with average daily aggregate notional amounts less than \$50 billion). Though this rule was proposed prior to the COVID-19 pandemic to align the CFTC initial margin compliance deadline with a similar extension adopted by the U.S. prudential banking regulators, the CFTC noted that the timing of this action is also aimed at addressing the spread of the coronavirus and its challenging effect on financial markets.

A link to a Debevoise Debrief discussing the extension may be found [here](#).

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Please do not hesitate to contact us with any questions.

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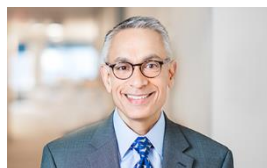


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