Banking and Finance Law Daily Wrap Up, FINANCIAL STABILITY—Agencies take further action to mitigate coronavirus impacts, (Mar. 17, 2020)

Following its lowering of the discount rate, the Federal Reserve Board, along with the OCC and FDIC, have taken further measures to mitigate coronavirus impacts on the financial system.

In the wake of the Dow Jones Industrial average losing nearly 13 percent of its value on March 16, 2020, despite the Federal Reserve Board’s lowering of the discount rate to new zero- to 0.25-percent level, the Fed, Office of the Comptroller of the Currency, and Federal Deposit Insurance Corporation have taken further steps to support the flow of credit to U.S. households and businesses, to enhance the liquidity of the U.S. dollar, and to encourage and guide banks with assisting customers and communities affected by the coronavirus outbreak.

The three agencies announced two new actions to support the U.S. economy and allow banks to continue lending to households and businesses.

Capital and liquidity buffers. In the first action, the agencies are encouraging banking organizations to use their capital and liquidity buffers as they respond to the challenges presented by the effects of the coronavirus. The agencies noted, in their statement, that since "the global financial crisis of 2007-2008, U.S. banking organizations have built up substantial levels of capital and liquidity in excess of regulatory minimums and buffers [and that the] largest banking organizations hold $1.3 trillion in common equity and $2.9 trillion in high quality liquid assets."

Given these amounts held by banking organizations, the statement continues that "[these] capital and liquidity buffers were designed to provide banking organizations with the means to support the economy in adverse situations and allow banking organization[s] to continue to serve households and businesses." If banking organizations choose to use their capital and liquidity buffers to lend and undertake other supportive actions, the agencies support those decisions provided it is done in a safe and sound manner; and that the banking organizations to continue to manage their capital actions and liquidity risk prudently.

Capital distributions. The agencies’ second action is an interim final rule that revises the definition of eligible retained income for all depository institutions, bank holding companies, and savings and loan holding companies subject to the agencies' capital rule. The interim final rule will also apply to the U.S. intermediate holding companies of foreign banking organizations required to be established or designated under 12 CFR 252.153. The revised definition of eligible retained income will make any automatic limitations on capital distributions that could apply under the agencies’ capital rules more gradual.

The agencies noted, "By modifying the definition of eligible retained income and therefore allowing banking organizations to more freely use their capital buffers, this rule should help to promote lending activity and other financial intermediation activities by depository institutions, bank holding companies, and savings and loan holding companies and avoid compounding negative impacts on the financial markets." The interim final rule becomes effective upon publication in the Federal Register.

CPFF 2020. Finally, the Fed announced that it will establish a Commercial Paper Funding Facility (CPFF), under its Federal Reserve Act Section 13(3) authority, to support the flow of credit to households and businesses. Under its terms and conditions, the CPFF will provide a liquidity backstop to U.S. issuers of commercial paper through a special purpose vehicle (SPV) that will purchase unsecured and asset-backed commercial paper rated A1/P1, as of March 17, 2020, directly from eligible companies. The Treasury will provide $10 billion of credit...
Agencies take further action to provide protection to the Fed in connection with the CPFF from the Treasury's Exchange Stabilization Fund. The Fed will then provide financing to the SPV under the CPFF. The Fed’s loans will be secured by all of the assets of the SPV.

The Fed noted, "By eliminating much of the risk that eligible issuers will not be able to repay investors by rolling over their maturing commercial paper obligations, this facility should encourage investors to once again engage in term lending in the commercial paper market. An improved commercial paper market will enhance the ability of businesses to maintain employment and investment as the nation deals with the coronavirus outbreak."