Banking and Finance Law Daily Wrap Up, CAPITAL AND BASEL ACCORDS—Fed clarifies call for banks to dip into capital and liquidity buffers, (Mar. 19, 2020)

Banking and Finance Law Daily Wrap Up

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By Jacob Bielanski

The Fed is assuring supervised banks, in a series of "Q&As," that ratings would not be affected solely based on buffers falling below regulatory levels, and that rule changes would help avoid "abrupt" regulatory restrictions on capital distributions.

The Federal Reserve Board is clarifying how it expects banks to use their collective $4.2 trillion in capital and liquidity buffers to mitigate the economic impacts of the coronavirus pandemic. The Board's March 19, 2020, letter (SR 20-5) addresses "public inquiries" from banks, and was distributed to the supervision directors at each of the Federal Reserve Banks. In its letter, the Board notes generally that regulators support using these buffers "to lend and undertake other supportive actions in a safe and sound manner." "The [Federal Reserve Board and other banking] agencies expect banking organizations to continue to manage their capital actions and liquidity risk prudently," the letter added.

The document comes after actions taken March 16 by the Board, first directly encouraging banks to use their liquidity buffers, as well as issuing an interim final rule on capital distributions to help banks dip into capital buffers without facing "abrupt" restrictions as a result. The latest "Q&A" addressed questions about those actions' larger regulatory impacts, including clarifications on how buffer usage affects large bank recovery and resolution plans, how the use of the Federal Reserve's 90-day discount window works, and the impact of these buffer draws on loss-absorbing capacity rules.

Loss-absorbing capacities and long-term debt ratios that fall within the buffer would trigger capital distribution limits, the Board said, to help ensure banks retain capital as they continue to lend to households and businesses. "Consistent with the interagency statement regarding the use of capital buffers, the Board encourages banking organizations to use their total loss-absorbing capacity buffers to lend and undertake other supportive actions in a safe and sound manner," the latest document said.

The Federal Reserve also said supervisors would not change banking organizations' assessments and ratings solely on the basis of buffer level changes as a result of usage. Banks whose buffers fall below regulatory requirements as a result of this latest usage would be addressed based on the "particular facts and circumstances facing the firm," despite those banks being required to submit plans for rebuilding such buffers. As part of those plans, high-quality liquid assets need not be rebuilt in a specific time period as part of the plan, the Board said.

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