Banking and Finance Law Daily Wrap Up, FINANCIAL STABILITY—Interim rules finalized neutralizing Regulatory Capital effects of using Lending Facilities, (Sept. 15, 2020)

Banking and Finance Law Daily Wrap Up

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The OCC, Fed and FDIC have adopted as final three interim rules addressing the treatment of certain Emergency Lending Facilities with regard to the Regulatory Capital Rule and the LCR Rule.

The Office of the Comptroller of the Currency, Federal Reserve Board, and Federal Deposit Insurance Corporation are adopting as final the revisions to the regulatory capital rule and the liquidity coverage ratio (LCR) rule made under three interim final rules issued earlier this year and published in the *Federal Register* on March 23, April 13, and May 6, 2020. Under the interagency final rule, banking organizations may continue to neutralize the regulatory capital effects of participating in the Money Market Mutual Fund Liquidity Facility (MMLF) and the Paycheck Protection Program Liquidity Facility (PPPLF), and are required to continue to neutralize the LCR effects of participating in the MMLF and the PPPLF. In addition, PPP loans will receive a zero percent risk weight under the agencies' regulatory capital rules.

The agencies are adopting these interim final rules as final with no changes. The final rule is effective 60 days after date of publication in the *Federal Register*.

Interim rules. The first interim final rule was issued along with the establishment of the Money Market Mutual Fund Liquidity Facility (MMLF). The interim rule provided capital and ensured that financial institutions would be able to effectively use the MMLF. It modifies the agencies' capital rules so that financial institutions receive credit for the low risk of their MMLF activities, reflecting the fact that institutions would be taking no credit or market risk in association with such activities (see *Banking and Finance Law Daily*, March 19, 2020).

The next rule allows banking organizations to neutralize the regulatory capital effects of participating in the PPPLF. To support use of the facility and, because there is no credit or market risk in association with PPP loans pledged to the facility, the rule allows banking organizations to exclude loans pledged as collateral to the facility from a banking organization's total leverage exposure, average total consolidated assets, advanced approaches total risk-weighted assets, and standardized total risk-weighted assets, as applicable. In addition, PPP loans receive a zero-percent risk weight under the agencies' regulatory capital rules regardless of whether they are pledged as collateral to the facility. However, these loans will be included in a banking organization's leverage ratio requirement unless they are pledged as collateral to the facility (see *Banking and Finance Law Daily*, April 9, 2020).

The third interim rule requires banks to neutralize the effect under the Liquidity Coverage Ratio rule of participating in the MMLF and PPPLF. It is intended to facilitate use of the lending facilities and to ensure that the effects of their use are consistent and predictable under the LCR rule. Absent the interim final rule, under the LCR rule, covered companies would be required to recognize outflows for MMLF and PPPLF loans with a remaining maturity of 30 days or less and inflows for certain assets securing the MMLF and PPPLF loans. As a result, a covered company's participation in the MMLF or PPPLF could affect its total net cash outflows, which could potentially result in an inconsistent, unpredictable, and more volatile calculation of LCR requirements across covered companies. The interim final rule adds a new definition and a new section to the LCR rule that requires Covered Federal Reserve Facility Funding and the assets securing such funding to be excluded from the calculation of a covered company's total net cash outflow amount as calculated under the LCR rule, notwithstanding any other section of the LCR rule. In most cases, this new section excludes advances made by

a Federal Reserve Bank under the MMLF or the PPPLF from being assigned an outflow rate, and any collateral securing such an advance from being assigned an inflow rate (see *Banking and Finance Law Daily*, May 5, 2020).

Comments received. According to the Staff Memorandum, the agencies received two comment letters, from a trade association and an advocacy organization, addressing the MMLF capital interim final rule. These commenters supported the agencies' actions to encourage banking organizations' participation in the emergency lending facility.

The agencies received 14 comment letters from industry participants, advocacy groups, trade associations, and individuals addressing the PPPLF interim final rule. Several commenters expressed support for the agencies' actions under the PPPLF capital interim final rule, while several commenters suggested that the agencies extend the zero percent risk weight to PPP covered loans purchased in secondary markets. Under the PPPLF capital interim final rule, the risk weight for all PPP covered loans is zero percent. Several commenters asserted that the PPPLF capital interim final rule should extend the leverage exclusion to PPP loans that are not pledged to the PPPLF, arguing that the treatment could discourage banking organizations that are not using the PPPLF from making PPP covered loans.

The agencies received one comment letter, from a trade association, in support of the LCR interim final rule.

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