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Initial U.S. Federal Banking Responses to the COVID-19 Pandemic

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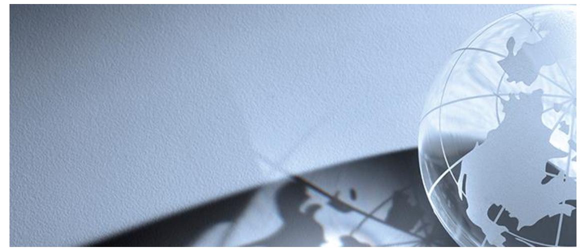

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The U.S. Congress and federal banking agencies have undertaken a wide range of measures and regulatory relief designed to limit the economic impact of the COVID-19 pandemic

On March 27, 2020, President Trump signed the Coronavirus Aid, Relief and Economic Security Act (the "**CARES Act**") into law after a marathon week of negotiations among Congressional leaders and administration officials.[1] The CARES Act, which is the largest fiscal stimulus bill in U.S. history, creates a number of new programs and authorities for executive branch agencies, particularly the Department of the Treasury ("**Treasury**") and the Board of Governors of the Federal Reserve System (the "**Federal Reserve**"), intended to help the U.S. economy in response to the Coronavirus Disease 2019 pandemic ("**COVID-19**"). The CARES Act is in addition to a number of programs implemented separately under prior authority by the Federal Reserve in response to COVID-19 that were intended to ensure liquidity and the availability of credit to businesses and households.

This note summarizes programs intended to stabilize the U.S. economy and regulatory relief granted by the Federal Reserve and other U.S. federal banking agencies. This note does not address all of the many substantive provisions of the CARES Act (e.g., tax relief)[2] and is not a comprehensive review of the still developing actions by various U.S. federal and state financial services regulators.[3]

Economic Stabilization

Since March 3, 2020, the Federal Reserve has taken a number of extraordinary steps to ensure the availability of credit in the U.S. market.[4] Among other things, the Federal Reserve has established a number of new credit facilities under Section 13(3) of the Federal Reserve Act, which permits Federal Reserve Banks

[1] The text of the CARES Act is available here.

[2] Our Note on the tax implications of the CARES Act is available here.

[3] Our Note on regulatory relief granted by the Securities & Exchange Commission is available here.

[4] Details about all of the Federal Reserve's action may be found on its COVID-19 resources page, which is available here.

to establish programs "with a broad-based eligibility" to extend credit to non-financial companies in "unusual and exigent circumstances." These credit facilities include the:

> **Commercial Paper Funding Facility (the "CPFF"):** funding a special purpose vehicle (an "**SPV**") that will purchase highly rated, three-month commercial paper from U.S. companies and the U.S. subsidiaries of non-U.S. companies;[5]

> **Primary Dealer Credit Facility:** extending credit to primary dealers in U.S. Treasuries against a wide range of collateral, including equity securities, for up to 90 days;

> **Money Market Mutual Fund Lending Facility (the "MMLF"):** extending credit to U.S. banks, bank holding companies and the U.S. branches and agencies of non-U.S. banks to purchase certain types of assets from money market mutual funds to ensure the liquidity of those funds;

> **Term Asset-Backed Securities Loan Facility (the "TALF"):** funding an SPV that will extend credit to U.S. companies, the U.S. subsidiaries of non-U.S. companies, and the U.S. branches and agencies of non-U.S. banks secured by non-synthetic, highly rated asset-backed securities ("**ABS**"):[6]

> **Primary Market Corporate Credit Facility (the "PMCCF")**: funding an SPV that will purchase bonds from and lend money to U.S. companies headquartered and with material operations in the United States that meet certain ratings criteria:[7] and

> **Secondary Market Corporate Credit Facility (the "SMCCF"):** funding an SPV that will purchase corporate debt and exchange-traded funds holding corporate debt on the secondary market.[8]

Treasury has capitalized the SPVs used in connection with the CPFF, TALF, PMCCF and SMCCF with $10 billion each from the Exchange Stabilization Fund (the "**ESF**"), and has provided credit protection of $10 billion with respect to the MMLF. The Federal Reserve also announced that it would establish a "Main Street Business Lending Program" to support lending to small- and medium-sized businesses (the "**Main Street Program**"). The Federal Reserve has not yet released any details about the Main Street Program.

5 In order to be eligible, an issuer must have had outstanding commercial paper between March 16, 2019 and March 16, 2020, and the SPV will purchase no more than the maximum amount of commercial paper the issuer had outstanding during that period.

6 Eligible ABS must have been originated by a U.S. company and be secured on certain classes of debt, including auto loans, student loans, credit card receivables, but not real estate mortgages (mortgage-backed ABS may be eligible for other Federal Reserve programs)

7 The maximum amount that the SPV will purchase from an issuer will vary depending on its credit rating.

8 To be eligible, a corporate bond must meet certain ratings criteria and be issued by a U.S. business with material operations in the U.S. An eligible ETF must provide broad exposure to U.S. investment grade corporate bonds.

In addition to the establishment of these facilities, the Federal Reserve has taken a number of steps to increase liquidity and the availability of credit. Among other things, the Federal Reserve:

> **Lowered benchmark rate**: lowered the target range of the benchmark federal funds rate from 1.75% - 2% to 0% - 0.25%;

> **Discount window lending**: encouraged banks to utilize the discount window to fund loans to businesses and individuals, and lowered the rate it charges on discount window loans from 1.75% to 0.25%; and

> **Asset buying**: announced a quantitative easing-style program under which the Federal Reserve Bank of New York will purchase U.S. Treasuries and agency mortgage-backed securities through its open market operations.

The CARES Act adds additional programs intended to help businesses of all sizes and certain sectors of the U.S. economy. These programs include:

> **Airline industry**: a program to lend money to, guarantee obligations of, or make other investments in U.S. air carriers and businesses deemed critical to U.S. national security of up to $46 billion. A participating company must agree not to conduct stock buybacks or pay dividends until one year after the term of the loan or guarantee, and must, "to the extent practicable," not reduce its March 24, 2020 employment levels by more than 10% until September 30, 2020 and agree to certain limitations on employee and executive compensation;[9]

> **Support for other businesses**: authorization of Treasury to make loans, guarantees and investments through a facility established by the Federal Reserve pursuant to Section 13(3) of the Federal Reserve Act. A participating company must be organized under the law of a U.S. state or U.S. federal law and have significant operations and a majority of its employees in the United States, and would be subject to limitations on stock buybacks, dividends and employee compensation similar to those described above;[10]

  > **Facility for medium-sized businesses**: Congress directed Treasury to seek the establishment of a Federal Reserve facility that will provide financing to banks and other lenders to make loans to mid-sized businesses with between 500 and 10,000 employees. Such loans would be capped at 2% interest and payments on the loan would be deferred for at least six months. Borrowers under such a program would be required to restore their employment to at least 90% of their pre-COVID-19 levels within four months of the end of the national emergency declaration, would face dividend and stock buyback restrictions similar to those described above, and would be prohibited

[9] CARES Act, § 4003(b)(1)-(3), (c)(2).

[10] CARES Act, § 4003(b)(4), (c)(3).

from "offshoring" any jobs until two years after repayment of the loans, among other things;[11]

> **"Paycheck Protection Program" for small businesses**: a program that would make loans available primarily to small businesses to cover payroll and overhead costs. Annual interest on the loans would be capped at 4%. Payments on the loan would be deferred for between six months and one year, and the principal and interest amounts due would be guaranteed by Treasury. Significant portions of a loan will be forgiven to the extent that the borrower maintains employee levels and compensation;[12]

> **Backstop of money market funds**: authorization for Treasury to backstop money market funds using the ESF;[13] and

> **FDIC insurance of non-depository liabilities**: authorization of the Federal Deposit Insurance Corporation to (1) guarantee certain non-deposit liabilities of banks and bank holding companies, and (2) increase the amount of deposit insurance for non-interest-bearing accounts.[14]

Regulatory Relief

In addition to establishing new credit facilities and taking monetary policy actions, the Federal Reserve, along with other U.S. federal banking agencies, has taken a number of steps to provide regulatory relief to U.S. banking organizations in an effort to encourage lending to borrowers affected by COVID-19. The CARES Act also contains a handful of provisions modifying certain regulatory requirements. Among other things, this regulatory relief includes:

> **Treatment of debt restructurings**: the CARES Act permits banks to suspend application of U.S. generally accepted accounting principles characterizing restructured loans to borrowers affected by COVID-19 as "troubled debt restructurings" or otherwise impaired, which can carry certain negative regulatory and financial consequences. This relief applies to loans modified until the earlier of the end of emergency declaration or December 31, 2020;[15]

> **Suspension of CECL methodology**: the CARES Act relieves banks and bank holding companies from any obligation to comply with current expected credit loss ("**CECL**") methodology, which could require banks to hold

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[11] CARES Act, § 4003(c)((3)(D). Congress made clear that the Federal Reserve retained the discretion to implement the Main Street Program or similar programs in addition to any lending programs established under the CARES Act. CARES Act, § 4003(c)(3)(D)(ii).

[12] CARES Act, § 1101, et seq.

[13] CARES Act, § 4015.

[14] CARES Act, § 4008.

[15] CARES Act, § 4013. The Federal Reserve and other banking agencies had previously issued guidance indicating that banks did not necessarily have to categorize modified loans as impaired provided certain criteria were met, though they did not grant relief from the application of GAAP.

additional reserves, until the earlier of the end of the emergency declaration or December 31, 2020;[16]

> **Acceleration of beneficial regulatory capital treatment for derivatives**: the Federal Reserve and other federal banking agencies have moved up the timeline for implementation of certain amendments to its regulatory capital rules that grant beneficial treatment to certain credit exposures arising from derivative transactions, permitting U.S. banks and bank holding companies to implement those amendments immediately;[17]

> **Use of capital and liquidity buffers**: the Federal Reserve and other federal banking agencies have encouraged banks to use the capital and liquidity buffers that they have built up since the 2008-09 financial crisis to help support lending. While the agencies did not relieve banks of the obligation to maintain the minimum amounts of capital and liquidity required by regulation, they indicated that capital and liquidity in excess of those amounts may be employed to support lending and suggested a certain degree of leniency with respect to banks that may drop below certain minimum liquidity requirements.[18] In addition, the agencies have modified certain regulatory capital definitions to permit banks to utilize more of their retained earnings in support of lending;[19]

> **Suspension of lending limits**: the CARES Act permits the Office of the Comptroller of the Currency (the "**OCC**") to permit banks to make loans that would exceed the lending limits normally applicable;[20]

> **Business continuity planning guidance**: the Federal Reserve and other federal banking agencies issued guidance concerning the business continuity obligations of regulated institutions during a pandemic;[21]

> **Changes in supervision**: the Federal Reserve announced that it would reduce its examination activities, particularly with respect to small banks, and delay banks' obligations to respond to certain supervisory filings.[22]

16 CARES Act, § 4014. Further, on March 27, 2020, the Federal Reserve and other federal banking agencies granted banks and bank holding companies subject to U.S. regulatory capital adequacy standards the option to delay for two years the effect of the CECL methodology on their regulatory capital requirements. *See* Regulatory Capital Rule: Revised Transition of the Current Expected Credit Losses Methodology Allowances (Mar. 27, 2020) (available here).

17 Standardized Approach for Calculating the Exposure Amount of Derivative Contracts (Mar. 27, 2020) (available here).

18 The agencies' statement is available here, and supporting FAQs are here.

19 The agencies' interim final rule on this issue is available here. The Federal Reserve issued a similar interim final rule with respect to its total loss-absorbing capital regulations, which is available here.

20 CARES Act, § 4011.

21 The agencies' guidance is available here.

22 Federal Reserve Statement on Supervisory Activities (Mar. 24, 2020) (available here). The agencies also granted small banks an additional 30 days to file certain financial reports. *See* Federal Reserve Offers Regulatory Reporting Relief to Small Financial Institutions Affected by the Coronavirus (Mar. 26, 2020) (available here).

In addition, the CARES Act and banking agencies have imposed certain forbearance obligations on banks, including:

> **Forbearance on federally backed loans**: under the CARES Act, lenders of certain federally backed mortgages must grant a forbearance of up to 360 days to borrowers experiencing financial hardship because of COVID-19. Servicers of such mortgages are prohibited from foreclosing on the underlying property (unless it is vacant or abandoned) until mid-May, whether a forbearance has been requested or not;[23]

> **Forbearance by New York-licensed institutions**: under an executive order issued by New York Governor Andrew Cuomo, failure by a financial institution supervised by the New York Department of Financial Services (including both New York-chartered banks and the New York-licensed U.S. branches of many non-U.S. banks) to grant a borrower experiencing financial distress because of COVID-19 a forbearance of at least 90 days would be considered an "unsafe and unsound practice," which could attract regulatory scrutiny.[24]

Conclusion

The CARES Act and the actions of the Federal Reserve and other federal banking agencies represent the most significant efforts to stimulate the U.S. economy since at least the 2008-2009 financial crisis, and many of their programs find historical precedents in that crisis. These programs will offer significant opportunities to businesses and banks alike. The harder work of implementing the many programs of the CARES Act is ahead, and it is likely that Treasury, the Federal Reserve and the Small Business Administration will spend the next several weeks putting the pieces in place. Ultimately, many of the programs will also impose significant burdens on banks and other financial institutions, which will play a prime role in getting credit out to borrowers.

We look forward to assisting our clients to address the legal and regulatory issues that they will face in the coming months.

If you have any questions, please do not hesitate to reach out to the people listed below or your usual Linklaters contacts.

23 CARES Act, § 4022, 4023.

24 N.Y. Exec. Order No. 202.9 (Mar. 21, 2020) (available here). The DFS subsequently issued emergency regulations to implement the order, which are available here. Federal banking agencies have repeatedly urged banks they supervise to work with such borrowers, though none have yet imposed an affirmative obligation to do so.

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