

April 27, 2020

**MEMORANDUM TO:** Board of Directors

**FROM:** Doreen R. Eberley, Director

**SUBJECT:** Interim Final Rule: *Liquidity Coverage Ratio Rule: Treatment of Certain Emergency Facilities*

**SUMMARY:** To provide liquidity to the money market sector, small business lenders, and the broader credit markets in order to stabilize the financial system, the Board of Governors of the Federal Reserve System (FRB) authorized the establishment of the Money Market Mutual Fund Liquidity Facility (MMLF) and the Paycheck Protection Program Lending Facility (PPPLF), pursuant to section 13(3) of the Federal Reserve Act. To facilitate use of these Federal Reserve facilities, and to ensure that the effects of their use are consistent and predictable under the Liquidity Coverage Ratio (LCR) rule, the Office of the Comptroller of the Currency (OCC), the FRB, and the FDIC (together, the agencies) propose to adopt an interim final rule to require banking organizations to neutralize the effect under the LCR rule of participating in the MMLF and the PPPLF.

**Recommendation:** Staff requests that the FDIC Board approve this interagency interim final rule, find that good cause exists for its adoption without advance notice, and authorize its publication in the *Federal Register* with an immediate effective date and with a comment period deadline of 30 days after the date of *Federal Register* publication.

**Concur:**

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Nicholas J. Podsiadly  
General Counsel

## **Discussion:**

### **I. Background**

The spread of the coronavirus disease 2019 (COVID-19) has slowed economic activity in many countries, including the United States. Financial conditions have tightened markedly, sudden disruptions in financial markets have put increasing liquidity pressure on money market mutual funds, and the cost of credit has risen for most borrowers. Given these liquidity pressures, money market mutual funds have been faced with redemption requests from clients with immediate cash needs and may need to sell a significant number of assets to meet such requests, which could further increase market pressures. Small businesses are also facing severe liquidity constraints, as millions of Americans have been ordered to stay home, severely reducing their ability to engage in normal commerce, and revenue streams for many small businesses have collapsed. This has forced many small businesses to close temporarily or furlough employees. Continued access to financing will be crucial for small businesses to weather economic disruptions caused by COVID-19 and, ultimately, to help restore economic activity.

In order to prevent the disruption in the money markets from destabilizing the financial system, the FRB, with the approval of the Secretary of the Treasury, authorized the Federal Reserve Bank of Boston to establish the Money Market Mutual Fund Liquidity Facility (MMLF), pursuant to section 13(3) of the Federal Reserve Act.<sup>1</sup> Under the MMLF, the Federal Reserve Bank of Boston extends non-recourse loans to eligible borrowers to purchase assets from money market mutual funds (MMFs). Assets purchased from MMFs are posted as collateral to the Federal Reserve Bank of Boston (MMLF collateral). Eligible borrowers under

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<sup>1</sup> 12 U.S.C. 343(3).

the MMLF include certain banking organizations subject to the agencies' Liquidity Coverage Ratio (LCR) rule (covered companies) issued by the agencies.<sup>2</sup> MMLF collateral generally comprises securities and other assets with the same maturity date as the MMLF non-recourse loan.

In order to provide liquidity to small business lenders and the broader credit markets and to help stabilize the financial system, the FRB, with the approval of the Secretary of the Treasury, authorized each of the Federal Reserve Banks to extend credit under the Paycheck Protection Program Lending Facility (PPPLF), pursuant to section 13(3) of the Federal Reserve Act.<sup>3</sup> Under the PPPLF, each of the Federal Reserve Banks extends non-recourse loans to institutions that are eligible to make Paycheck Protection Program (PPP) covered loans,<sup>4</sup> including depository institutions subject to the agencies' LCR rule. Under the PPPLF, only PPP covered loans that are guaranteed by the SBA under the PPP with respect to both principal and interest and that are originated by an eligible institution may be pledged as collateral to the Federal Reserve Banks (PPPLF collateral). The maturity date of the extension of credit under the PPPLF equals the maturity date of the PPP loans pledged to secure the extension of credit.<sup>5</sup>

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<sup>2</sup> The applicability of LCR rule is described in section \_\_.1 of the rule. See 12 CFR 50.1 (OCC); 12 CFR 249.1 (FRB); and 12 CFR 329.1 (FDIC).

<sup>3</sup> 12 U.S.C. 343(3).

<sup>4</sup> Congress created the PPP as part of the Coronavirus Aid, Relief, and Economic Security Act (CARES Act) (Pub. L. 116-136, March 24, 2020) and in recognition of the exigent circumstances faced by small businesses. PPP covered loans are fully guaranteed as to principal and accrued interest by the Small Business Administration (SBA) and also afford borrower forgiveness up to the principal amount of the PPP covered loan, if the proceeds of the PPP covered loan are used for certain expenses. Under the PPP, eligible borrowers generally include businesses with fewer than 500 employees or that are otherwise considered to be small by the SBA. The SBA reimburses PPP lenders for any amount of a PPP covered loan that is forgiven. PPP lenders are not held liable for any representations made by PPP borrowers in connection with a borrower's request for PPP covered loan forgiveness. For more information on the Paycheck Protection Program, see <https://www.sba.gov/funding-programs/loans/coronavirus-relief-options/paycheck-protection-program-ppp>.

<sup>5</sup> The maturity date of the PPPLF's loan will be accelerated if the underlying PPP loan goes into default and the eligible borrower sells the PPP Loan to the Small Business Administration (SBA) to realize on the SBA guarantee. The maturity date of the PPPLF's loan also will be accelerated to the extent of any PPP loan forgiveness reimbursement received by the eligible borrower from the SBA.

To facilitate the use of the MMLF and PPPLF, staff requests that the FDIC Board adopt this interagency interim final rule, which would require covered companies to neutralize the LCR effects of the advances made by each facility and the exposures securing such facility advances.

## **II. The Interim Final Rule**

### ***A. LCR treatment of MMLF and PPPLF Funding***

The agencies' LCR rule requires covered companies to calculate and maintain an amount of high-quality liquid assets (HQLA) sufficient to cover their total net cash outflows over a 30-day stress period. A covered company's LCR is the ratio of its HQLA amount (LCR numerator) divided by its total net cash outflows (LCR denominator). The total net cash outflow amount is calculated as the difference between outflow and inflow amounts, which are determined by applying a standardized set of outflow and inflow rates to the cash flows of various assets and liabilities, together with off-balance sheet items, as specified in sections \_\_.32 and \_\_.33 of the LCR rule.<sup>6</sup>

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.

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<sup>6</sup> Section \_\_.30 of the LCR rule also requires a covered company, as applicable, to include in its total net cash outflow amount a maturity mismatch add-on, which is calculated as the difference (if greater than zero) between the covered company's largest net cumulative maturity outflow amount for any of the 30 calendar days following the calculation date and the net day 30 cumulative maturity outflow amount. See 12 CFR 50.30 (OCC); 12 CFR 249.30 (FRB); and 12 CFR 329.30 (FDIC).

Under the LCR rule, secured loans from a Federal Reserve facility with a remaining maturity of 30 calendar days or less are categorized as secured funding transactions with a sovereign entity and assigned an outflow rate that varies based on the collateral securing the loan.<sup>7</sup> In addition, the LCR rule assigns inflow rates to collateral generally based on the asset and counterparty type.<sup>8</sup> As a result of the applicable inflow and outflow rates in the LCR rule, MMLF and PPPLF transactions could receive a non-neutral liquidity risk treatment. Moreover, after these loans are extended and upon their maturity, the associated inflows and outflows could unnecessarily contribute to volatility in LCRs.

Under the terms of the MMLF and PPPLF, covered companies use the value of cash received from posted or pledged assets to repay the MMLF or PPPLF loan, respectively, and in no case is the maturity of the collateral shorter than the maturity of the advance. In addition, because the advance from the Federal Reserve Bank is non-recourse, the banking organization is not exposed to credit or market risk from the collateral securing the MMLF or PPPLF loan that could otherwise affect the banking organization's ability to settle the loan. For these reasons, the agencies believe that it would be appropriate to provide predictable and consistent treatment for participation in the MMLF and PPPLF by neutralizing the effects of participation in the MMLF and the PPPLF on covered companies' LCRs. Absent this interim final rule, the agencies believe that the LCR rule's treatment of covered companies' transactions with the MMLF and PPPLF would not be consistent across transactions or facilities and would not accurately reflect the liquidity risk associated with funding exposures through these facilities.

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<sup>7</sup> See 12 CFR 50.32(j)(1)(i)-(iii) (OCC); 12 CFR 249.32(j)(1)(i)-(iii) (FRB); and 12 CFR 329.32(j)(1)(i)-(iii) (FDIC).

<sup>8</sup> See 12 CFR 50.33 (OCC); 12 CFR 249.33 (FRB); and 12 CFR 329.33 (FDIC).

Specifically, the interim final rule would add a new definition to section \_\_.3 and a new section \_\_.34 to the LCR rule. In section \_\_.3, the new definition “Covered Federal Reserve Facility Funding” would mean a “non-recourse loan that is extended as part of the Money Market Mutual Fund Liquidity Facility or Paycheck Protection Program Lending Facility authorized by the Board of Governors of the Federal Reserve System pursuant to section 13(3) of the Federal Reserve Act.” The new section \_\_.34 would require 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 section \_\_.30 of the LCR rule, notwithstanding any other section of the LCR rule. Except as described below, this new section would exclude advances made by a Federal Reserve Bank under the MMLF or the PPPLF from being assigned an outflow rate under section \_\_.32 of the LCR rule, and any collateral securing such an advance from being assigned an inflow rate under section \_\_.33 of the LCR rule. While this treatment would neutralize the effect of the use of the facilities on a covered company’s LCR for the duration of the facility, banking organizations should be mindful of the need, where applicable, to replace maturing Covered Federal Reserve Facility Funding with appropriate alternative sources in instances where exposures mature later than such funding.

This new section \_\_.34 would not apply to the extent the covered company secures Covered Federal Reserve Facility Funding with securities, debt obligations, or other instruments issued by the covered company or its consolidated entity. When a covered company owns an instrument that it or its consolidated entity issued, the covered company will not receive a payment from outside the consolidated covered company upon maturity that would be available to repay the borrowing (Covered Federal Reserve Facility Funding), and, as a result, this arrangement presents liquidity risk due to the asymmetric cash flows of the covered company

because the covered company would not have an inflow to offset its cash outflows.<sup>9</sup> It would, therefore, be inappropriate to eliminate such a funding transaction under the LCR rule.

The agencies intend to seek comment on all aspects of the interim final rule.

### **III. Effective Date**

#### ***A. Administrative Procedure Act***

Staff requests that the Board authorize issuance of the interim final rule without prior notice and the opportunity for public comment and the delayed effective date ordinarily prescribed by the Administrative Procedure Act (APA).<sup>10</sup> Pursuant to section 553(b)(B) of the APA, general notice and the opportunity for public comment are not required with respect to a rulemaking when an “agency for good cause finds (and incorporates the finding and a brief statement of reasons therefor in the rules issued) that notice and public procedure thereon are impracticable, unnecessary, or contrary to the public interest.”<sup>11</sup>

Further, staff believes that the public interest is best served by implementing the interim final rule immediately upon its publication in the *Federal Register*. As discussed above, the spread of COVID-19 has slowed economic activity in many countries, including the United States. In particular, the COVID-19 pandemic has acutely affected small businesses, MMFs, and financial markets generally.

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<sup>9</sup> The covered company would not record a payment to itself in the amount owed for the instrument issued by the covered company or its consolidated entity; this would be eliminated in the process of consolidating the covered company’s financial statements.

<sup>10</sup> 5 U.S.C. 553.

<sup>11</sup> 5 U.S.C. 553(b)(B).

In the absence of this interim final rule, staff believes that banking organizations may be restricted in their ability to use the MMLF and PPPLF.<sup>12</sup> The urgent funding pressures facing small businesses and MMFs justify the adoption of this interim final rule as quickly as possible. For these reasons, staff requests that the Board find that there is good cause consistent with the public interest to issue the interim final rule without advance notice and comment.<sup>13</sup>

The APA also requires a 30-day delayed effective date, except for (1) substantive rules that grant or recognize an exemption or relieve a restriction; (2) interpretative rules and statements of policy; or (3) as otherwise provided by the agency for good cause.<sup>14</sup> For the reasons described above, staff requests that the Board find good cause to exempt the interim final rule from the APA's delayed effective date requirement.<sup>15</sup>

***B. Riegle Community Development and Regulatory Improvement Act of 1994***

Pursuant to section 302(a) of the Riegle Community Development and Regulatory Improvement Act (RCDRIA),<sup>16</sup> in determining the effective date and administrative compliance requirements for new regulations that impose additional reporting, disclosure, or other requirements on insured depository institutions (IDIs), each Federal banking agency must consider, consistent with the principle of safety and soundness and the public interest, any administrative burdens that such regulations would place on depository institutions, including

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<sup>13</sup> *Id.*

<sup>14</sup> 5 U.S.C. 553(d).

<sup>15</sup> 5 U.S.C. 553(d)(1).

<sup>16</sup> 12 U.S.C. 4802(a).

small depository institutions, and customers of depository institutions, as well as the benefits of such regulations. In addition, section 302(b) of the RCDRIA requires new regulations and amendments to regulations that impose additional reporting, disclosures, or other new requirements on IDIs generally to take effect on the first day of a calendar quarter that begins on or after the date on which the regulations are published in final form, with certain exceptions, including for good cause.<sup>17</sup> For the reasons described above, staff requests that the Board find good cause under section 302 of the RCDRIA to publish the interim final rule with an immediate effective date.

**Conclusion:**

Staff requests that the FDIC Board approve this interim final rule, find that good cause exists for its adoption without advance notice, and authorize its publication in the *Federal Register* with an immediate effective date and with a 30-day comment period following its publication in the *Federal Register*.

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<sup>17</sup> 12 U.S.C. 4802.

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