Federal Banking Regulators Modify the Liquidity Coverage Ratio for Banks Participating in the Money Market Mutual Fund Liquidity Facility and the Paycheck Protection Program Liquidity Facility

On May 5, 2020 the Board of Governors of the Federal Reserve System (the "Federal Reserve"), the Federal Deposit Insurance Corporation, and the Office of the Comptroller of the Currency (collectively, the "Joint Regulators") adopted an interim final rule that neutralizes the liquidity coverage ratio (LCR) impact for banks participating in the Federal Reserve's Money Market Mutual Fund Liquidity Facility and the Paycheck Protection Program Liquidity Facility.

As described in our prior client alert, in order to prevent the destabilization of money market mutual funds, the Federal Reserve has established the Money Market Mutual Fund Liquidity Facility (MMLF). 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 the MMLF include certain banking organizations subject to the Liquidity Coverage Ratio. MMLF collateral generally consists of securities and other assets with the same maturity date as the MMLF loan.

The Coronavirus Aid, Relief, and Economic Security (CARES) Act also established the Paycheck Protection Program (PPP) under which qualifying financial institutions make loans to qualifying businesses with fewer than 500 employees that 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 loan, if the proceeds of the loan are used for certain expenses.[1] The Federal Reserve has established the Paycheck Protection Program Liquidity Facility (PPPLF) under which Federal Reserve Banks make non-recourse loans to institutions, including banking institutions subject to the LCR, that make PPP loans. Under the PPPLF, PPP loans that are guaranteed by the SBA under the PPP may be pledged as collateral to the relevant Federal Reserve Bank. 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.

As the Joint Regulators indicate in the release accompanying the interim final rule, under the terms of the MMLF and PPPLF, banking institutions 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 relevant 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. As a result, the Joint Regulators indicate that it it is appropriate in their view to neutralize the LCR effect for banking institutions participating in the MMLF and PPPLF.

The interim final rule adds new definition of "Covered Federal Reserve Facility Funding" to the LCR rule, which means a non-recourse loan that is extended as part of the MMLF or PPPLF. A new § __.34 is also added, which requires "Covered Federal Reserve Facility Funding" and the assets securing such funding to be excluded from the calculation of a banking institution's total net cash outflow amount calculated under LCR rule, notwithstanding any other section of the LCR rule.

New § __.34 does not apply to the extent a banking institution secures “Covered Federal Reserve Facility Funding” with securities, debt obligations, or other instruments issued by the banking institution or any entity consolidated with the banking institution.

The interim final rule is effective on the date it is published in the Federal Register.

For More Information

If you would like further information concerning the matters discussed in this article, please contact the Chapman attorney with whom you regularly work.

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1 See our prior client alert with respect to the PPP here.

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