Regulatory Alert for Financial Services

Regulatory Insights

April 2020

Financial services regulatory expectations for COVID-19: #4

Treasury and the Federal Reserve have expanded the number and scope of credit facilities to allow for continued liquidity across credit types and markets. Demands on the financial institutions lending activities are increasing, further straining operations, credit, loss mitigation, and compliance. Regulatory actions highlight attention on consumer/investor protections, including conduct and fair treatment, as financial services firms (institutions, and nonbanks such as mortgage servicers) implement new programs, such as the SBA's PPP and the FRB's Main Street Lending Program, and also work through loan modifications, forbearance requests, and loss mitigation efforts tied to the COVID-19 pandemic and select provisions in the CARES Act.

Expansion of Credit Availability

In its capacity as the central bank, the Federal Reserve Board (FRB) in conjunction with the Department of the Treasury:

— Announced new credit facilities, including:

- The Paycheck Protection Program Liquidity Facility (PPPLF) to "bolster the effectiveness" of the SBA's Paycheck Protection Program (PPP). The PPPLF is intended to supply liquidity to participating financial institutions through term financing backed by PPP loans.
- The Main Street Lending Program, which consists of two separate facilities – the Main Street New Loan Facility (MSNLF) and the Main Street Expanded Loan Facility (MSELF). Eligible borrowers include U.S. businesses with not more than 10,000 employees or with 2019 revenues of $2.5 billion or less. Eligible firms seeking Main Street loans must commit to maintain payroll and follow compensation, stock repurchase, and dividend restrictions that apply to direct loan programs under the CARES Act. Eligible banks may originate new Main Street loans or use Main Street loans to increase the size of existing loans to businesses. The minimum loan size is $1 million; banks must retain a 5 percent share.

  Eligible borrowers in the MSELF may not also participate in the MSNLF or the Primary Market Corporate Credit Facility. However, firms that participate in the PPP may also take out Main Street loans. (Treasury will provide $75 billion to the two Main Street facilities combined.)
- The Municipal Liquidity Facility (MLF) is intended to help States and certain municipalities manage their cash flows (which may be strained by providing essential services in response to the COVID-19 pandemic while tax receipts are delayed by the deferred tax date and businesses are closed by the "stay-at-home" guidelines.) The MLF will purchase eligible notes at the time of issuance. Eligible notes include tax anticipation notes, tax and revenue anticipation notes, and bond anticipation notes with terms of no more than 24 months. (Treasury's initial equity investment in the MLF will be $35 billion.)

— Expanded, in size and scope, the Primary Market Corporate Credit Facility (PMCCF) and the Secondary

Market Corporate Credit Facility (SMCCF), which will be used to purchase corporate debt, as well as the Term Asset-Backed Securities Loan Facility (TALF), which will now accept "highly rated newly issued collateralized loan obligations and legacy commercial mortgage-backed securities as eligible collateral." (Treasury will invest a total of $85 billion in these facilities.)

— Opened the registration process and announced the launch of the Commercial Paper Funding Facility (CPFF). The CPFF will provide a liquidity backstop to U.S. issuers of commercial paper through a special purpose vehicle that will purchase eligible three-month unsecured commercial paper and asset-backed commercial paper from eligible issuers using financing provided by the Federal Reserve Bank of New York.

Concurrently, there is growing attention focused on the risk that mortgage servicers may not be able to meet obligations to their investors in the wake of an increase in forbearance requests by borrowers, as permitted by the CARES Act. None of the current FRB credit facilities is directed toward mortgage servicers. The FHFA has stated that Fannie Mae and Freddie Mac will not provide a liquidity facility to the servicers of their loans, while Ginnie Mae has announced an assistance program.

Current debates in Congress

— The popularity of the SBA's Paycheck Protection Program has spurred members of the House Financial Services Committee majority to publicize a letter they sent to several large financial institutions seeking periodic updates on the banks' implementation of the PPP and other pandemic efforts, including information on the number of applications they receive, how they prioritize processing those applications, the number of applications approved, any conditions tied to a loan approval, and the types of assistance beyond funds being provided to applicants.

— A bipartisan group of Senators has asked the Financial Stability Oversight Council to provide temporary liquidity to struggling mortgage servicers, noting the funds made available to Treasury's Exchange Stabilization Fund through the CARES Act.

Recent Federal Regulatory Actions

Banking Regulators

Federal Banking Agencies (FRB, FDIC, OCC):

— Issued an interim final rule to permit banking organizations to "neutralize" the regulatory capital effects of participating in the PPPLF and to clarify that a zero percent risk weight applies to loans covered by the PPP for capital purposes.

— Issued two interim final rules to temporarily modify the Community Bank Leverage Ratio and provide for a transition and grace period. Beginning in the second quarter of 2020, the ratio will be set at 8 percent. It will rise to 8.5 percent for calendar year 2021, and 9 percent thereafter.

— Issued interagency statements with the CFPB and the Conference of State Bank Supervisors to:

  – Revise their previous statement on loan modifications and troubled debt restructurings (TDRs) to clarify the interaction between the agencies' guidance and related provisions in the CARES Act (section 4013). The agencies state they view loan modification programs as positive actions that can mitigate adverse effects on borrowers due to COVID-19; they will not criticize institutions for working with borrowers in a safe and sound manner and COVID-19-related modifications generally do not need to be categorized as TDRs. The agencies stress that when working with borrowers, institutions must make good faith efforts to support borrowers and comply with the consumer protection requirements, including fair lending laws.

  – Provide mortgage servicers that offer or provide a borrower a short-term payment forbearance option, including a CARES Act forbearance, with flexibility in complying with the mortgage servicing rules under the Real Estate Settlement Procedures Act and Regulation X. (The CARES Act provides a forbearance option for borrowers with "federally backed mortgage loans" in sections 4022 and 4023.) Broadly, the agencies will provide flexibility with regard to application, notice, and contact requirements, provided the mortgage servicer makes a good faith effort to comply. The interagency statement is supplemented by, and references, a frequently asked questions document published by the CFPB on the mortgage servicing rules and COVID-19.

Capital Markets Regulators

SEC:

— Issued an order providing temporary conditional exemptive relief for business development companies (BDCs) to enable them to make additional investments in small and medium-sized businesses, including those with operations affected by COVID-19.

— Published two risk alerts outlining expectations for inspections of compliance with Regulation Best Interest and Form CRS, which go into effect on June 30, 2020. The SEC has stated that the deadlines "remain appropriate" as they are conduct and transparency initiatives that will benefit Main Street investors, especially in these times of uncertainty.

FINRA:

— Announced that it will take the same approach as set forth in the SEC Risk Alerts when FINRA examines broker-dealers and their associated persons for compliance with Regulation Best Interest and Form CRS. In addition FINRA published highlights of firm practices it observed when conducting preparedness reviews for Regulation Best Interest.

— Proposed a rule change to address brokers with a significant history of misconduct.

CFTC:

— Voted to extend the comment period on multiple rule proposals to provide participants additional time and flexibility. Links to the extensions are available here.

State Regulatory Actions

Most state insurance regulators are recommending a variety of consumer related measures in response to COVID-19 including:

— Expanding auto insurance to cover restaurant deliveries using personal vehicles

— Calling on insurers to provide auto policy holders with partial rebates or discounts amid the sudden decline in driving.

This in addition to previous requests/requirements that insurers offer policyholders more lenient payment terms and not cancel or non-renew policies during the crisis.

California's Insurance Commissioner has ordered insurers to refund some premiums to all adversely affected California policy holders in insurance lines with a decreased risk of loss due to the crisis, including private passenger and commercial automobile, workers' compensation, commercial multi-peril and liability, and medical malpractice. The order covers premiums for at least March and April, and could extend through May if statewide stay-at-home restrictions remain in place.

Separately, an increasing number of state legislatures (Ohio, Louisiana, Massachusetts, New Jersey, Pennsylvania and South Carolina) have introduced bills seeking to retroactively remove standard business interruption exclusions for losses caused by viral or bacterial pandemics.

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Regulatory Alert | Financial services regulatory expectations for COVID-19: #3

Regulatory Alert | Financial services regulatory expectations and response to COVID-19: #2

Regulatory Alert | Regulatory expectations for COVID-19

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