ALERT MEMORANDUM

Response to COVID-19: U.S. Government Financial Sector Initiatives

Update of March 20, 2020 at 12:00 pm

This week the U.S. federal government announced a raft of significant new programs and policies aimed at stabilizing the markets, addressing immediate liquidity concerns, and facilitating lending and other assistance to businesses and individuals affected by shutdowns due to COVID-19. Many of the initiatives announced were modeled on similar programs employed in the 2008 financial crisis.

The most significant initiatives announced this week included:

- A lending facility to support money market mutual funds;
- A repo facility to allow access to short-term liquidity for primary dealers; and
- A commercial paper facility to increase liquidity for businesses that issue commercial paper.

Potential additional measures that are under active consideration and could be enacted in coming days include:

- Expanded Federal Reserve lending facilities to other sectors, perhaps in a form similar to the financial crisis-era Term Asset-Backed Securities Loan Facility;
- Regulatory relief for financial institutions aimed at supporting increased lending;
- A Treasury guarantee of money market mutual funds; and
- Economic stimulus legislation that would support lending to sectors hit hardest.

Below we provide a concise summary of the key programs and initiatives to date, as well as an update on programs and legislation that are under active consideration.

Our March 17, 2020 alert memorandum highlighting key measures used by the government during the 2008 financial crisis is available here.

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Measures Taken to Confront Financial Impact of COVID-19

- Federal Reserve Actions to Increase Liquidity
  - ***Money Market Mutual Fund Liquidity Facility ("MMLF").***

    On March 18, 2020, the Federal Reserve announced the establishment of the MMLF pursuant to its authority under Section 13(3) of the Federal Reserve Act ("**Section 13(3)**"). The MMLF will terminate on September 30, 2020 unless extended.

    - Purpose: To provide liquidity to money market mutual funds in order to ensure that such funds can meet the demands for redemptions by households and businesses, thereby supporting credit provision to the economy.
    - Structure: Under the MMLF, the Federal Reserve Bank of Boston will make nonrecourse loans of one year or less to U.S. depository institutions, U.S. bank holding companies and their U.S. broker-dealer subsidiaries and U.S. branches and agencies of foreign banks at a rate equal to the primary credit rate of the applicable reserve bank (currently Boston). These loans will be secured by high-quality assets, including U.S. Treasuries, agency securities, secured commercial paper, unsecured commercial paper rated A1/P1/F1 and receivables from certain repurchase agreements, purchased by these institutions from money market mutual funds, including single state and other tax-exempt municipal money market mutual funds. Treasury, using the Exchange Stabilization Fund ("**ESF**"), will provide $10 billion of credit protection to the Federal Reserve Bank of Boston.
    - Approvals: Treasury approved the establishment of this program under Section 13(3).
    - Comparison to 2008 Financial Crisis Program: The MMLF is structurally similar to the Asset-Backed Commercial Paper Money Market Mutual Fund Liquidity Facility ("**AMLF**") that the Federal Reserve operated from 2008 to 2010. However:
      - The MMLF allows institutions to purchase a broader range of assets from money market mutual funds, as the AMLF was limited to purchases of asset-backed commercial paper;
      - Treasury did not provide credit protection under the AMLF; and
      - In this instance, the Federal Reserve, Federal Deposit Insurance Corporation ("**FDIC**") and Office of the Comptroller of the Currency ("**OCC**") issued an interim final rule that exempts any asset acquired with funds obtained in connection with the MMLF from risk-based capital and leverage requirements because such assets will be pledged to the Federal Reserve.
  - ***Primary Dealer Credit Facility ("PDCF").***

    On March 17, 2020, the Federal Reserve announced the establishment of the PDCF pursuant to its authority under Section 13(3). The PDCF will be available to primary dealers for at least six months, or longer if conditions warrant.

    - Purpose: To provide cash through repo arrangements with primary dealers to enable them to support smooth market functioning and facilitate the availability of credit to businesses and households.
    - Structure: Under the PDCF, the Federal Reserve Bank of New York ("**FRBNY**") will extend overnight and term repo funding with maturities up to 90 days to primary dealers at a rate equal to the FRBNY's primary credit rate. This repo funding will be secured by certain eligible collateral, including collateral that can be pledged in open market operations, investment-grade corporate debt securities, international agency

securities, commercial paper, municipal securities, mortgage-backed securities, asset-based securities and equity securities.

- Approvals: Treasury approved the establishment of this program under Section 13(3).
- Comparison to 2008 Financial Crisis Program: The PDCF is structurally similar to the PDCF that was in effect between 2008 and 2010. However, the 2008-2010 PDCF only provided overnight, not term, loans to primary dealers.

- ***Commercial Paper Funding Facility ("CPFF").***

  On March 17, 2020, the Federal Reserve announced it was establishing a CPFF utilizing its authority under Section 13(3). The CPFF will terminate on March 17, 2021 unless extended by the Federal Reserve.

  - Purpose: To provide a liquidity backstop to U.S. issuers of commercial paper, including U.S. issuers with a foreign parent. Commercial paper markets directly finance a wide range of economic activity and provide liquidity that businesses use to meet operational needs.
  - Structure: The CPFF is structured as an FRBNY-financed special purchase vehicle, which will purchase unsecured three-month U.S.-denominated commercial paper (including asset-backed commercial paper) rated A1/P1/F1 from U.S. issuers of commercial paper, including U.S. issuers with a foreign parent. Treasury is providing a $10 billion backstop to the FRBNY in connection with the CPFF using the ESF.
  - Approvals: Treasury approved the establishment of this program under Section 13(3).
  - Comparison to 2008 Financial Crisis Program: The CPFF is structurally similar to the CPFF that the Federal Reserve operated from 2008 to 2010. However, Treasury did not provide a backstop to the FRBNY in connection with the 2008-2010 CPFF.

- ***Central Bank Liquidity Swap Lines***.

  On March 15, 2020, the Federal Reserve announced that it was coordinating with the Bank of Canada, the Bank of England, the Bank of Japan, the European Central Bank and the Swiss National Bank to enhance the provision of liquidity via standing U.S. dollar liquidity swap line arrangements. On March 19, 2020, the Federal Reserve announced that it was establishing additional temporary U.S. dollar liquidity swap line arrangements with foreign central banks pursuant to its authority under Section 14 of the Federal Reserve Act. On March 20, the Federal Reserve announced that it was increasing the frequency of operations with the Bank of Canada, the Bank of England, the Bank of Japan, the European Central Bank and the Swiss National Bank via the standing swap line arrangements.

  - Purpose: To improve liquidity conditions in dollar funding markets in the United States and abroad by providing foreign central banks with the capacity to deliver U.S. dollar funding to institutions in their jurisdictions in times of market stress.
  - Structure: Under the arrangements with the Bank of Canada, the Bank of England, the Bank of Japan, the European Central Bank and the Swiss National Bank, these central banks will lower the pricing to the U.S. dollar overnight index swap rate plus 25 basis points. These foreign central banks also agreed to offer additional maturities of U.S. dollars (84 days in addition to one week) to increase the swap lines' effectiveness. On March 20, 2020, these central banks agreed to increase the frequency of seven-day maturity operations from weekly to daily commencing on March 23, 2020 and continuing at least through the end of April. The arrangements with the Reserve Bank of Australia, the Banco Central do Brasil, the Bank of Korea, the Banco de Mexico, the Monetary Authority of Singapore and the Sveriges Riksbank

(Sweden) will support the provision of U.S. dollar liquidity in amounts up to $60 billion each and up to $30 billion each with Danmarks Nationalbank (Denmark), the Norges Bank (Norway) and the Reserve Bank of New Zealand.

- Approvals: No approvals required.
- Comparison to 2008 Financial Crisis Program: The Federal Reserve instituted similar arrangements with central banks during the 2008 financial crisis.

o ***Large-Scale Asset Purchases***.

On March 15, 2020, the Federal Reserve announced that, over the coming months, the FRBNY would purchase at least $500 billion in U.S. Treasury securities and at least $200 billion in agency mortgage-backed securities. As part of this program, on March 19, 2020, the FRBNY purchased $10 billion in agency mortgage-backed securities for settlement on March 23, 2020. The FRBNY will reinvest all principal payments from its holdings of agency debt and agency mortgage-backed securities in agency mortgage-backed securities. Federal Reserve Chairman Powell indicated, on March 15, 2020, that the Federal Reserve is not currently, or actively considering in the future, seeking authority from Congress to buy assets other than U.S. Treasuries and agency mortgage-backed securities. However, the Federal Reserve is likely to surpass its $500 billion pledge to purchase U.S. Treasury securities since the Federal Reserve has disclosed purchases totaling more than half that amount since March 14, 2020. The Federal Reserve is also likely to surpass its $200 billion pledge to purchase agency mortgage-backed securities within the same timeframe.

o ***Discount Window Access***.

On March 15, 2020, the Federal Reserve encouraged depository institutions to turn to the discount window to meet demands for credit, lowered the primary credit rate to 0.25% and extended the timeframe for borrowing to 90 days to support credit demands. On March 19, 2020, the Federal Reserve indicating it was "encouraged" by the increase in discount window borrowing during this week.

o ***Cutting Interest Rates***.

On March 3, 2020, the Federal Reserve lowered its target Fed funds rate by half a percentage point—its first unscheduled and largest interest rate cut since 2008. On March 15, 2020, it further lowered target Fed funds rates to 0–0.25%, an additional full percentage point cut.

- Additional Federal Reserve Actions

o ***Restrictions on Distributions***.

On March 17, 2020, the Federal Reserve released an interim final rule focused on alleviating the possibility of a sudden onset of restrictions on distributions if banks dip into their required capital buffers. All banking organizations will be able to calculate their distribution restrictions based on the greater of (1) a banking organization's net income for the four preceding calendar quarters, net of any distributions and associated tax effects, and (2) the average of a banking organization's net income over the preceding four quarters.

o ***Reserve Requirements***.

On March 15, 2020, the Federal Reserve announced the elimination of the reserve requirement for depository institutions, a move designed to free up funds to support lending to households and businesses.

- Joint Actions by the Federal Reserve, FDIC and OCC
  - ***Community Reinvestment Act ("CRA").***

    On March 19, 2020, the Federal Reserve, FDIC and OCC encouraged banks to work with customers and communities affected by COVID-19, particularly those that are low- and moderate-income. The agencies emphasized that prudent efforts to modify and/or ease the terms on new or existing loans for such customers would receive CRA consideration and not be subject to examiner criticism.
  - ***Capital and Liquidity Buffers***.

    On March 15, 2020, the Federal Reserve encouraged banks to use capital and liquidity buffers built up since the 2008 financial crisis to lend to households and businesses affected by COVID-19. On March 17, 2020, the Federal Reserve, FDIC and OCC reiterated in a joint statement that banks should use their buffers to support lending activity. On March 19, 2020, the Federal Reserve, FDIC and OCC issued questions and answers in response to public inquiries on this statement. For more information regarding the capital and liquidity issues, please see our alert memorandum available here.
- FDIC Actions
  - ***FDIC Guidance***.

    On March 13, 2020, the FDIC encouraged financial institutions to assist customers and communities affected by COVID-19. The FDIC specifically urged financial institutions to work with borrowers, especially small businesses and borrowers from industry sectors that are most affected by the current situation, including by potentially modifying terms of existing loans. The FDIC also noted that it will work with affected financial institutions to reduce the burden of examinations, such as by increasing use of off-site reviews, and with financial institutions that may experience challenges fulfilling their regulatory reporting responsibilities.
- New York State Department of Financial Services ("*NYDFS*") Actions
  - ***NYDFS Preparedness Plan***.

    On March 10, 2020, NYDFS issued a letter requiring each of its regulated institutions to submit a plan of preparedness for managing the risk of disruption to its services and operations due to COVID-19 as soon as possible, and in no event later than April 9, 2020. The NYDFS also issued a letter on the same day requiring each of its regulated institutions to submit a plan regarding managing the potential financial risk to the institution arising from COVID-19 on the same timeline.

Possible Additional Measures Under Consideration

In addition to these actions, the federal banking regulators are considering, and the industry is lobbying for, additional interventions. We have provided a brief summary below of measures that may be used in the near future based on public reporting.

- ***Lending to Consumers and Small Businesses***.

  The Federal Reserve may establish a facility to lend directly to businesses, rather than providing credit indirectly to the real economy through banks. It remains unclear whether the ultimate form of this facility will require Congressional approval, or whether the Federal Reserve may rely on its authority under Section 13(3). In either case, Treasury is expected to provide credit support as it has with several of the other lending facilities that have been established in response to market disruptions driven by COVID-19. The structure of

this facility could be more indirect, however, and could be modeled on the financial crisis-era Term Asset-Backed Securities Loan Facility, which provided non-recourse loans to any U.S. company holding AAA-rated asset-based securities backed by consumer and small business loans to encourage liquidity and funding of those loans. There are currently legislative proposals pending before Congress on these issues, and Treasury sent a proposed term sheet to Congress for its consideration.

- ***Regulatory Relief***.

  The Federal Reserve, FDIC and OCC are considering additional regulatory relief measures that are designed to limit the effect of COVID-19 on bank balance sheets or to bolster the effectiveness of lending facilities.

  - First, the banking agencies are considering relaxing leverage ratio requirements. This change is expected to provide relief for banks with large broker-dealer affiliates that have been unable to sell assets due to reduced liquidity in the market. Banking organizations may see declining leverage ratios as they expand their balance sheets due to acting as liquidity providers or otherwise increasing lending activity in the current accommodative monetary policy environment.
  - Second, the banking agencies are considering a delay by one year in the effectiveness of the current expected credit loss accounting standard. This form of relief would provide banks with the ability to continue to use current accounting standards, which do not require banks to recognize expected future losses immediately and therefore limit balance sheet impairments from COVID-19's economic effects.
  - Third, additional changes, such as a relaxation of the OCC's leveraged lending guidelines, are reportedly on the table.

- ***Money Market Mutual Fund Guarantee***.

  While the Federal Reserve has established the MMLF to provide liquidity to money market funds, Treasury is considering requesting additional authority from Congress to guarantee assets held by money market funds. This may be necessary to support the commercial paper market, in which money market funds are significant buyers of obligations. This authority would potentially sunset with the expiration of the President's declared national emergency related to COVID-19.

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Cleary Gottlieb has established a COVID-19 Resource Center, providing information and thought leadership on developing events. In addition, we have a COVID-19 Task Force that is acting as a repository for practical solutions, best practice and issue-spotting to help our clients by sharing market experience, insight and advice from across our global presence.

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