

# COVID-19 RESPONSE: FINANCIAL REGULATORS SEEK TO BLUNT IMPACT WITH EMERGENCY MEASURES

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## U.S. Public Policy and Law Alert

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## INTRODUCTION

As a result of the recent outbreak of COVID-19, financial markets and institutions have experienced significant disruptions. In response, financial institutions have sought to lessen the impact of COVID-19 through the implementation of business continuity plans, the displacement of personnel from normal business sites, and otherwise responding to roiling market conditions. On March 13, 2020, the President declared a National Emergency and many states and localities have declared a state of emergency.

Financial regulators including the Federal Reserve Board ("FRB"), Federal Deposit Insurance Corporation ("FDIC"), the Office of the Comptroller of the Currency ("OCC"), the Consumer Financial Protection Bureau ("CFPB"), the National Credit Union Administration ("NCUA"), the Securities and Exchange Commission ("SEC"), and the Commodity Futures Trading Commission ("CFTC") have each issued guidance to market participants.

This alert highlights some of the most important developments from the FRB and other Prudential Regulators, the SEC, the CFTC, and the committees of jurisdiction in Congress. Financial institutions and other market participants should expect this regulatory guidance to be updated as regulators seek to blunt the impact of COVID-19.

## Practical Guidance

- Market participants should, where needed, seek specific guidance from their primary regulator as they seek to meet the needs of their customers, personnel, and business. Market participants should engage with key regulators and legislators in order to ensure that effective policies are enacted to confront the disruption caused by COVID-19.
- Because regulators are in uncharted territory, regulatory guidance may not be particularly detailed. Market participants should seek operational relief early and provide clear justifications for the requested relief.
- The federal banking regulators are still focused on safety and soundness, even though they are encouraging depository institutions to use capital and liquidity reserves to assist consumers and businesses.

- The Federal Reserve Board will likely expand lending activities under its Section 13(3) authority as measures to address COVID-19 become more aggressive.
- The SEC has taken several steps to ensure that markets continue to function smoothly, even in light of significant market volatility.
- The CFTC has recently issued several waves of no-action relief to help facilitate orderly trading and liquidity in the derivatives markets.
- In short, market participants should make reasonable efforts to demonstrate compliance with applicable regulations where business has been disrupted. Such efforts should be documented and provided to regulators as appropriate.

## THE FRB ESTABLISHES A COMMERCIAL PAPER FUNDING FACILITY UNTIL MARCH 17, 2021 AND A PRIMARY DEALER CREDIT FACILITY

To address growing concerns that consumers and businesses will not have access to credit as the spread of the coronavirus undermines the U.S. market, the FRB announced on March 17, 2020 that it will establish a commercial paper funding facility ("Facility"). The Facility will use a special purpose vehicle designed to purchase unsecured and asset-backed commercial papers that are rates A1/P1 directly from eligible companies to serve as a backstop for commercial paper issuers. According to the FRB, "commercial paper markets directly finance a wide range of economic activity, supplying credit and funding for auto loans and mortgages as well as liquidity to meet the operational needs of a range of companies." The first \$10 billion to finance the Facility will be provided by the Treasury Department as credit protection through its Exchange Stabilization Fund. Subsequently, the Federal Reserve Bank of New York will lend to the Facility; such loans will be secured by the special purpose vehicle's assets. The Facility will be open until March 17, 2021, unless the FRB determines otherwise. A further description of the facility can be found [here](#).

The FRB established the Facility to mitigate the risk of slowed or stopped lending in the event that issuers are unable to compensate investors who are about to roll over their maturity commercial paper. Notably, the FRB does not need additional Congressional approval to open the Facility. Section 13(3) of the Federal Reserve Act authorizes the FRB to "discount for any participant in any program or facility with broad-based eligibility, notes, drafts, and bills of exchange when such notes, drafts, and bills of exchange are indorsed or otherwise secured to the satisfaction of the Federal Reserve bank" "in unusual and exigent circumstances." In contrast, the Department of Treasury, pursuant to the Dodd-Frank Act, must notify Congress prior to authorizing nonbank institutions to access liquidity through the FRB's discount window.

We expect that the FRB and Treasury will expand the categories of eligible collateral as the need for such relief becomes evident.

Also on March 17, the FRB [announced](#) it will establish a Primary Dealer Credit Facility ("PDC Facility") under its Section 13(3) authority, which will be operational by March 20. The PDC Facility will offer overnight and term funding with maturities up to 90 days for at least the next six months at the primary credit rate or discount rate offered by the New York Federal Reserve Bank. All credit extended by the PDC Facility will need to be collateralized by investment grade debt securities, including commercial paper and municipal bonds, as well as equity securities. Please see [here](#) for the term sheet.

## PRUDENTIAL REGULATORS' JOINT GUIDANCE TO ADDRESS COVID-19 AND CHANGES TO RESTRICTIONS ON DISTRIBUTIONS

The FRB, the FDIC, the OCC, the CFPB, the NCUA, and the Conference of State Bank Supervisors (collectively, the "Prudential Regulators") have issued a series of joint guidance documents over the last week aimed at encouraging financial institutions to be more flexible in meeting consumers' and businesses' financial needs in light of COVID-19.

On March 9, the Prudential Regulators released their first such [guidance](#), stating that "financial institutions [should] meet the financial needs of customers and members affected by the coronavirus." To facilitate financial services, the Prudential Regulators will "provide appropriate regulatory assistance to affected institutions subject to their supervision" and will expedite approval of providing services in affected communities. Importantly, the guidance notes that "[p]rudent efforts that are consistent with safe and sound lending practices should not be subject to examiner criticism," and that examinations can be scheduled in a manner that minimizes disruptions.

On March 16, the FRB, OCC, and the FDIC (the "Federal Banking Regulators") issued a joint [statement](#) encouraging depository institutions to use the Federal Reserve's discount window to facilitate liquidity in the economy. The statement emphasized that use of the "discount window supports the smooth flow of credit to households and businesses."

Then on March 17, the Federal Banking Regulators issued another joint [statement](#) announcing two new actions to support depository institutions' ability to lend to consumers and businesses. The first was a pledge that they will "support banking organizations that choose to use their capital and liquidity buffers to lend and undertake other supportive actions in a safe and sound manner." The statement emphasized the need for depository institutions to "continue to manage their capital actions and liquidity risk prudently" while also noting that "[t]he largest banking organizations hold \$1.3 trillion in common equity and \$2.9 trillion in high quality liquid assets." The second was a "technical change to phase in, as intended, the automatic distribution restrictions gradually if a firm's capital levels decline." To this end, the Federal Banking Regulators issued an [interim final rule](#) that revised the definition of eligible retained income to "the greater of (1) a banking organization's net income for the four preceding calendar quarters, net of any distributions and associated tax effects not already reflected in net income, and (2) average of a banking organization's net income over the preceding four quarters." According to the rule, "[t]his definition will apply with respect to all of a banking organization's buffer requirements, including the fixed 2.5 percent capital conservation buffer, and, if applicable, the countercyclical capital buffer, the GSIB surcharge, and enhanced supplementary leverage ratio standards."

## THE SEC PROVIDES MARKET RELIEF IN RESPONSE TO COVID-19

In the midst of extreme market volatility, the SEC has taken several steps to provide guidance to investors and operational relief to issuers.

Through the first half of March, the SEC took several actions related to COVID-19. For instance, the SEC [announced](#) that it will provide conditional regulatory and filing relief for issuers affected by the coronavirus.<sup>[1]</sup> The SEC issued an order that provides publicly traded companies an additional 45 days to file certain disclosure reports, however, these companies must provide a justification for the relief. Additionally, the SEC [issued](#) two orders for regulatory relief related to reporting deadlines and board meetings for funds and investment advisers who may be affected by COVID-19. This relief is designed to allow the affected parties to continue their day-to-

day operations, even with the restrictions on travel, gatherings, and access to their working places brought on by the coronavirus.

The SEC also issued [staff guidance](#) to assist concerned parties and other market participants affected by the virus with their upcoming annual shareholder meetings.[2] The guidance aims to enable these companies to be able to hold their meetings, aided with the use of technology and to still be able to comply with all federal laws. The SEC is also offering some flexibility with companies hoping to change the date and location of their meetings, as well as permitting virtual meetings. The SEC has noted that it may add additional relief as circumstances change.

On February 19, SEC Chairman Clayton and Chairman William Duhnke III of the Public Company Accounting Oversight Board ("PCAOB") issued a [joint statement](#) addressing audit quality in China, particularly with respect to PCAOB inspections and reporting considerations with respect to the coronavirus.

For additional insights into the SEC's response to COVID-19 and its implications for capital markets participants, please see K&L Gates' alert [here](#).

#### CFTC Provides Relief for Market Participants

On March 17, 2020, the Staff of the Commodity Futures Trading Commission ("CFTC") [issued](#) several no-action letters providing temporary, targeted relief to swap dealers, introducing brokers, futures commission merchants, retail foreign exchange dealers, and floor brokers. CFTC Staff [also issued](#) similar no-action relief for the markets it regulates: futures exchanges (i.e., designated contract markets) and swap execution facilities. CFTC Chairman Tarbert noted that these "prudent, targeted, and temporary actions will help facilitate orderly trading and liquidity in our derivatives markets. The CFTC remains squarely focused on promoting their integrity, resilience, and vibrancy through sound regulation." These actions are discussed in detail below for each category of registrant.

#### Relief for Futures Commission Merchants

CFTC Staff has granted temporary, targeted no-action relief to futures commission merchants ("FCMs") and introducing brokers ("IBs") from CFTC regulations requiring recording of oral communications related to voice trading and other telephonic communications, as well as the time-stamping requirements when located in remote, socially-distanced locations. CFTC Staff also granted 30 days of no-action relief to FCMs from the requirement to furnish annual compliance reports to the CFTC. (See CFTC Letter No. [20-03](#)).

#### Relief for Swap Dealers

CFTC Staff has granted temporary, targeted no-action relief to Swap Dealers from CFTC regulations requiring recording of oral communications related to voice trading and other telephonic communications, as well as the time-stamping requirements when located in remote, socially-distanced locations. CFTC Staff has also granted 30 days of no-action relief to swap dealers from the requirement to furnish annual compliance reports to the CFTC. (See CFTC Letter No. [20-06](#)).

#### Relief for Swap Execution Facilities

CFTC Staff has granted temporary, targeted no-action relief to swap execution facilities ("SEFs") from CFTC regulations requiring recording of oral communications related to voice trading and other telephonic communications. Due to the displacement of personnel, SEFs will be unable to comply with certain audit trail requirements, recordkeeping requirements related to maintaining a complete audit trail, and monitoring

requirements related to audit trail reconstruction. This relief expires on June 30, 2020. Because SEFs have reprioritized and reallocated personnel that otherwise would have been involved in the preparation and submission of reports, such as the annual compliance report, CFTC Staff has also provided an extension of time to submit filings in order to allow SEFs to continue to focus on supporting orderly and resilient markets. (See CFTC Letters No. [20-07](#) and [20-08](#)).

### Relief for Designated Contract Markets

CFTC Staff has granted temporary, targeted no-action relief to certain designated contract markets ("DCMs") from audit trail and related requirements. This relief was necessary due to the displacement of market participants, such as floor brokers, from trading floors and other designated premises from which they may enter orders. This relief expires on June 30, 2020. (See CFTC Letter No. [20-09](#)).

### Relief for Members of Swap Execution Facilities and Designated Contract Markets

CFTC Staff has granted temporary, targeted no-action relief to members of SEFs and DCMs from time-stamping requirements when located in remote, socially-distanced locations. (See CFTC Letter No. [20-02](#)). CFTC Staff also issued no-action relief for retail foreign exchange dealers and floor brokers.<sup>[3]</sup>

CFTC-registered Self-Regulatory Organizations and market participants have also taken measures in response to COVID-19. The National Futures Association has issued three Notices to Members stating that they are [monitoring COVID-19](#), [reminding swap dealer members of their CFTC regulatory reporting requirements](#), and [relaxing branch office requirements to allow for alternative work arrangements](#). The CME Group [announced](#) that it had closed its Chicago trading floor as a precaution to reduce large gatherings that can contribute to the spread of coronavirus.

Given the pace of developments, CFTC Staff has noted that market participants should document deviations from compliance procedures, ensure that such alternative efforts are reasonable, and communicate with CFTC Staff.

## CONGRESSIONAL ENGAGEMENT WITH FINANCIAL REGULATORS ON THEIR COVID-19 RESPONSE

The House Financial Services Committee's Chairwoman, Maxine Waters (D-CA), [led six letters](#) to financial regulators and related industry organizations expressing concerns about risks related to COVID-19 and inquiring about the steps being taken to protect Americans and the financial system. There is particular concern that certain protections could be weakened in response to the coronavirus. Chairwoman Waters stressed her complete opposition to any attempts to rollback important financial regulations by these organizations.

The Chairwoman also noted that the Committee will be holding a hearing on the financial implications of COVID-19 in March. A date has not been set for this hearing. The announcement of a March hearing on the coronavirus preceded the [announcement](#) that all other remaining Committee and subcommittee hearings scheduled for March have been postponed.

## LOOKING AHEAD

Market participants should engage with their regulators, seek relief, and document any changes from regular regulatory compliance procedures, particularly those related to recordkeeping, recording, reporting, and surveillance.

The financial services team at K&L Gates is prepared to assist market participants navigate these developments, the evolving regulatory landscape for market participants and financial products, and recent and proposed changes by U.S. regulators as they respond to the COVID-19 pandemic.

[1] See Mark L. Johnson, Sean M. Jones, Coleman Wombwell, K&L Gates LLP, COVID-19: SEC Announces Conditional Relief for Companies Affected by Coronavirus, (Mar. 5, 2020), <http://www.klgates.com/sec-announces-conditional-relief-for-companies-affected-by-coronavirus-03-05-2020/>

[2] See Mark L. Johnson, Sean M. Jones, Margaret N. Rosenfeld, Amy S. Wallace, Coleman Wombwell, K&L Gates LLP, COVID-19: Securities Law Considerations for U.S. Public Companies, (Mar. 16, 2020), <http://www.klgates.com/covid-19--securities-law-considerations-for-us-public-companies-03-13-2020/>

[3] Relief for Retail Foreign Exchange Dealers. The CFTC has granted temporary, targeted no-action relief to retail foreign exchange dealers from CFTC regulations requiring recording of oral communications related to voice trading and other telephonic communications as well as time-stamping requirements when located in remote, socially-distanced locations. (See CFTC Letter No. 20-05).

Relief for Floor Brokers. The CFTC has granted temporary, targeted no-action relief to floor brokers from CFTC regulations requiring recording of oral communications related to voice trading and other telephonic communications as well as time-stamping requirements when located in remote, socially-distanced locations. The CFTC has also granted relief from the requirement to be located on the premises of a designated contract market and to register as introducing brokers, which might otherwise have been triggered in connection with trading activities undertaken at remote, socially-distanced locations. (See CFTC Letter No. 20-04).

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