Q&As on Statement Regarding the Use of Capital and Liquidity Buffers

The Board, FDIC, and Office of the Comptroller of the Currency (agencies) are encouraging banking organizations to use their capital and liquidity buffers as they respond to the challenges presented by the effects of the coronavirus.

Since the global financial crisis of 2007-2008, U.S. banking organizations have built up substantial levels of capital and liquidity in excess of regulatory minimums and buffers. The largest banking organizations hold $1.3 trillion in common equity and $2.9 trillion in high quality liquid assets (HQLA). The agencies also significantly increased capital and liquidity requirements, including improving the quality of regulatory capital, raising minimum capital requirements and establishing capital and liquidity buffers, and implementing annual capital stress tests.

These capital and liquidity buffers were designed to provide banking organizations with the means to support the economy in adverse situations and allow banking organization to continue to serve households and businesses. The agencies 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 agencies expect banking organizations to continue to manage their capital actions and liquidity risk prudently.

These Q&As respond to public inquiries from banking organizations regarding the use of their capital and liquidity buffers, and the application of the Board's total loss-absorbing capacity rule.

Q&As by Topic

Liquidity Buffers

1. **Could the agencies clarify the meaning of a "liquidity buffer" and provide further information on how a banking organization is allowed to use such a buffer in times of stress?**

"Liquidity buffer" refers to the stock of liquid assets that a banking organization manages to enable it to meet expected and unexpected cash flows and collateral needs without adversely affecting the banking organization's daily operations. Supervisors encourage banking organizations to make prudent use of their liquidity buffers in times of stress in order to continue to meet obligations to creditors and other counterparties while also continuing to support households and businesses.

If a banking organization is subject to the liquidity coverage ratio and its liquidity coverage ratio is less than 100 percent, it must submit a plan to its supervisor. The plan must be appropriate to the circumstances of the banking organization and the economic environment; there is no requirement to rebuild HQLA within a specific time period.

The supervisory response to a banking organization that has a liquidity buffer that falls below any applicable regulatory requirements will depend on the particular facts and circumstances facing the firm. Supervisors will engage with management on the banking organization's plan for rebuilding its liquidity buffer. In addition, supervisors will not change the supervisory assessment and rating of a banking organization solely on this basis.

2. **Could the agencies provide clarity on the purpose of the 90-day draws on the discount window and whether prepayment would impact the maturity of the loan for LCR purposes?**

The agencies are encouraging banking organizations to use the discount window to meet their liquidity needs, especially as banks deploy their liquid assets to support the needs of households and businesses; the Board has made changes to the program to encourage its use. Borrowing from the discount window is now available up to 90 days, and this borrowing receives favorable treatment under the agencies' liquidity coverage ratio rule. In terms of prepayment, as the U.S. government is the counterparty, the liquidity coverage ratio rule allows a firm to assume the original maturity date.

Capital Buffers

3. **Could the agencies clarify the meaning of a "capital buffer," and the meaning of regulatory minimums and provide further information on how a banking organization is allowed to use such a buffer in times of stress?**

"Capital buffer" refers to capital held above regulatory minimum requirements. The statement on use of capital buffers reinforced the principle that is appropriate for banking organizations to use their buffers in times of stress to lend and undertake other actions that support the economy in a safe and sound manner.

Banking organizations with regulatory capital ratios that are below their capital buffer requirement face gradual restrictions on capital distributions and discretionary bonus payments. These restrictions encourage banking organizations to conserve capital within the organization as they lend to households and businesses and as their capital levels approach minimum regulatory capital requirements. The statement itself did not modify the levels or distribution restrictions associated with the buffers in the capital rule or change the agencies' prompt corrective action regulations. However, on March 17, 2020, the agencies modified the buffer restrictions by revising the definition of eligible retained income through an interim final rule to ensure the automatic restrictions apply gradually as intended.[1] By increasing the amount of retained income available for distribution, this modification will allow banking organizations to dip into their capital buffers and continue lending without facing abrupt regulatory restrictions.

Recovery and Resolution Plan Triggers

4. **How does the statement on buffer usability interact with triggers included in a recovery plan or a resolution plan?**

Recovery and resolution plans for some of the largest banking organizations contain triggers that identify when and under what conditions a firm is transitioning from business-as-usual conditions to a stress period. Early triggers are generally focused on prompting appropriate internal governance processes and an initial conversation between supervisors and the firm.

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[1] See https://www.federalreserve.gov/newsevents/pressreleases/bcreg20200317a.htm

Total Loss-Absorbing Capacity Rule

5. **Could the Board confirm whether the statement related to Use of Capital and Liquidity Buffers applies to total loss-absorbing capacity and long-term debt requirements?**

Similar to the capital rule, the Board's total loss-absorbing capacity rule includes minimum requirements of total loss-absorbing capacity and long-term debt, as well as buffers in excess of such requirements that impose increasingly stringent restrictions on distributions as a banking organization approaches the minimum requirements. Consistent with the interagency statement regarding the use of capital buffers, the Board encourages banking organizations to use their total loss-absorbing capacity buffers to lend and undertake other supportive actions in a safe and sound manner.

A banking organization whose loss-absorbing capacity and long-term debt ratios fall into the buffers would be subject to restrictions on its capital distributions, which helps to ensure that banking organizations conserve capital as they lend to households and businesses.