April 7, 2020

MEMORANDUM TO: Board of Directors

FROM: Doreen R. Eberley, Director

SUBJECT: Regulatory Capital Rule: Paycheck Protection Program Lending Facility and Paycheck Protection Program Loans

SUMMARY: To provide liquidity to small business lenders and the broader credit markets, to help stabilize the financial system, and to provide economic relief to small businesses nationwide, the Board of Governors of the Federal Reserve System ("FRB") on April 7, 2020, authorized each of the Federal Reserve Banks to establish the Payment Protection Program Lending Facility ("PPPL Facility"), pursuant to section 13(3) of the Federal Reserve Act. Under the PPPL Facility, each of the Federal Reserve Banks will extend non-recourse loans to eligible financial institutions to fund loans guaranteed by the Small Business Administration ("SBA") under the Paycheck Protection Program ("PPP") established by the Coronavirus Aid, Relief, and Economic Security Act ("CARES Act"). To facilitate use of the PPPL Facility, staff is presenting for approval of the Federal Deposit Insurance Corporation ("FDIC") Board of Directors ("FDIC Board") a request to adopt and publish the attached interagency interim final rule ("interim final rule"), to allow banking organizations to neutralize the regulatory capital effects of participating in the facility. This treatment is similar to the treatment extended previously by the FDIC, FRB, and Office of the Comptroller of the Currency (together, the "agencies") in connection with the Federal Reserve's Money Market Mutual Fund Liquidity

Concur:

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Nicholas J. Podsiadly
General Counsel

Facility. In addition, as mandated by section 1102 of the CARES Act, loans originated under the SBA's PPP will receive a zero percent risk weight under the agencies' capital rules.

Recommendation: Staff requests that the FDIC Board approve this interagency interim final rule and authorize its publication in the *Federal Register* with an immediate effective date and with a comment period deadline of 30 days after the date of *Federal Register* publication.

Discussion:

I. Background

The spread of the coronavirus disease 2019 ("COVID-19") has slowed economic activity in many countries, including the United States. Financial conditions have tightened markedly, and the cost of credit has risen for most borrowers. Small businesses are acutely impacted by the COVID-19 pandemic. As millions of Americans have been ordered to stay home, severely reducing their ability to engage in normal commerce, revenue streams for many small businesses have collapsed. This has resulted in severe liquidity constraints at small businesses and forced many small businesses to close temporarily or furlough employees. Continued access to financing will be crucial for small businesses to weather economic disruptions caused by COVID-19 and, ultimately, to help restore economic activity.

As part of the CARES Act and in recognition of the exigent circumstances faced by small businesses, Congress created the PPP. PPP covered loans are fully guaranteed as to principal and accrued interest by the SBA, the amount of each being determined at the time the guarantee is exercised. As a general matter, the SBA guarantees are backed by the full faith and credit of the U.S. Government. PPP covered loans also afford borrowers forgiveness up to the principal amount of the PPP covered loan, if the proceeds of the PPP covered loan are used for certain expenses. The SBA reimburses PPP lenders for any amount of a PPP covered loan that is forgiven. PPP lenders are not held liable for any representations made by PPP borrowers in connection with a borrower's request for PPP covered loan forgiveness.

Under the PPP, eligible borrowers generally include businesses with fewer than 500 employees or that are otherwise considered by the SBA to be small, including individuals operating sole proprietorships or acting as independent contractors, certain franchisees, nonprofit corporations, veterans organizations, and Tribal businesses.[1] The loan amount under the PPP would be limited to the lesser of $10 million and 250 percent of a borrower's average monthly payroll costs.[2]

In order to provide liquidity to small business lenders and the broader credit markets, and to help stabilize the financial system, on April 7, 2020, the FRB, with approval of the Secretary of the Treasury, authorized each of the Federal Reserve Banks to extend credit under the PPPL Facility, pursuant to section 13(3) of the Federal Reserve Act.[3] Under the PPPL Facility, each of the Federal Reserve Banks will extend non-recourse loans to institutions that are eligible to make PPP covered loans, including depository institutions subject to the agencies' capital rule.[4] Under the PPPL Facility, only PPP covered loans that are guaranteed by the SBA under the PPP with respect to both principal and interest and that are originated by an eligible institution may be pledged as collateral to the Federal Reserve Banks (eligible collateral).

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[1] For more information on the PPP, see https://www.sba.gov/funding-programs/loans/coronavirus-relief-options/paycheck-protection-program-ppp.

[2] Id.

[3] 12 U.S.C. § 343(3).

[4] See 12 CFR part 3 (OCC); 12 CFR part 217 (FRB); 12 CFR part 324 (FDIC).

To facilitate the use of this facility, the interim final rule would allow banking organizations to neutralize the regulatory capital effects of loans pledged to the PPPL Facility. This relief, which applies to both risk-based and leverage capital ratios, including the community bank leverage ratio, is consistent with the treatment that the agencies previously provided to banking organizations to facilitate use of the Federal Reserve's Money Market Mutual Fund Liquidity Facility.[5]

II. The Interim Final Rule

A. Regulatory capital treatment of PPPL Facility exposures

The agencies' capital rule requires banking organizations to comply with risk-based and leverage capital requirements, which are expressed as a ratio of regulatory capital to assets and certain other exposures. Risk-based capital requirements are based on risk-weighted assets, whereas leverage capital requirements are based on a measure of average total consolidated assets or total leverage exposure. Participation in the PPPL Facility will affect the balance sheet of an eligible banking organization because, as a function of participating in the PPPL Facility, the banking organization must originate and hold PPP covered loans (that is, assets that are eligible collateral pledged to the Federal Reserve Banks) on its balance sheet.[6] As a result, an

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[5] See Regulatory Capital Rule: Money Market Mutual Fund Liquidity Facility, 80 FR 16232 (March 23, 2020). This treatment also is consistent with relief provided in connection with the Asset-Backed Commercial Paper Money Market Mutual Fund Facility in 2008, 73 Fed. Reg. 55706 (Sept. 26, 2008).

[6] Under the Small Business Administration's the interim final rule, a lender may request that the Small Business Administration purchase the expected forgiveness amount of a PPP covered loan or pool of PPP covered loans at the end of week seven of the covered period. *See* Interim Final Rule "Business Loan Program Temporary Changes; Paycheck Protection Program," https://www.sba.gov/sites/default/files/2020-04/PPP--IFRN%20FINAL_0.pdf.

eligible banking organization that participates in the PPPL Facility could potentially be subject to increased regulatory capital requirements.

The regulatory capital requirements for PPP covered loans pledged by a banking organization to a Federal Reserve Bank as part of the PPPL Facility do not reflect the substantial protections from risk provided to the banking organization by the facility. Because of the non-recourse nature of the Federal Reserve's extension of credit to the banking organization, the banking organization is not exposed to credit or market risk from the pledged PPP covered loans. Therefore, staff of the agencies believe that it would be appropriate to exclude the effects of these pledged PPP covered loans from the banking organization's regulatory capital.[7]

Specifically, the interim final rule would permit banking organizations to exclude exposures pledged as collateral to the PPPL Facility from a banking organization's total leverage exposure, average total consolidated assets, advanced approaches-total risk-weighted assets, and standardized total risk-weighted assets, as applicable.[8]

B. Regulatory capital treatment of PPP covered loans

The agencies' capital rule requires a banking organization to apply a zero percent risk weight to the portion of exposures that is unconditionally guaranteed by a U.S. government agency for purposes of the banking organization's risk-based capital requirements.[9] Section 1102 of the CARES Act requires banking organizations to apply a zero percent risk weight to PPP covered loans. Accordingly, and consistent with section 1102 of the CARES Act, the interim final rule would amend the capital rule to clarify that PPP covered loans originated by a

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[7] This includes covered PPP loans originated beginning on April 3, 2020, and pledged to the Federal Reserve Banks in connection with this facility.

[8] This treatment would extend to the community bank leverage ratio.

[9] _See_ 12 CFR 3.32(a)(1) (OCC); 12 CFR 217.32(a)(1) (FRB); 12 CFR 324.32(a)(1) (FDIC).

banking organization under the PPP will receive a zero percent risk weight.

Conclusion:

Staff requests that the FDIC Board approve this interim final rule and authorize its publication in the *Federal Register* with an immediate effective date and with a comment period deadline of 30 days after the date of *Federal Register* publication.

Staff Contacts:

<u>RMS/Capital Markets</u>

Bobby Bean, Associate Director (ext. 8-6705)

Ben Bosco, Chief, Capital Policy Section (ext. 8-6853)

Noah Cuttler, Senior Policy Analyst (ext. 8-3556)

<u>Legal</u>

Michael Phillips, Counsel (ext. 8-3581)

Catherine Wood, Counsel (ext. 8-3788)

Jennifer Jones, Counsel (ext. 8-6768)