INSIGHT

Banking Regulators' Response to COVID-19

March 25, 2020

Economic conditions have deteriorated rapidly in the past few weeks, as the coronavirus (COVID-19) outbreak has caused many businesses and public institutions to limit or close their operations. Policymakers are considering a range of programs and policy options to assist Americans facing increased financial hardship and those incurring time off work because of illness.

Once it became clear that the COVID-19 outbreak would have serious financial ramifications for households and businesses, the federal agencies that regulate banks and credit unions—the Federal Reserve, the Office of the Comptroller of the Currency, the Federal Deposit Insurance Corporation, and Consumer Financial Protection Bureau (collectively referred to as the bank regulators), and the National Credit Union Administration—responded in two general ways as discussed in this Insight:

- measures to encourage banks to work with customers affected by COVID-19; and
- adjustments to bank regulation related to capital, liquidity, and supervision.

Assisting Affected Consumers

Regulators' efforts to deal with the potential effects of COVID-19 began in early March with attempts to ensure that depository institutions were adequately planning for the potential risks. On March 6, 2020, the Federal Financial Institutions Examination Council (FFIEC) updated its influenza pandemic guidance to minimize the potentially adverse effects of COVID-19. The guidance identifies business continuity plans as a key tool to address pandemics and provides a comprehensive framework to ensure the continuation of critical operations.

In the past month, regulators have shifted focus to providing guidance on how to address and serve customers affected by the virus. (For more on policy options for financial services companies responding to customers affected by COVID-19, see CRS Insight IN11244, *The Financial Industry and Consumers Struggling to Pay Bills during the COVID-19 (Coronavirus) Outbreak*, by Cheryl R. Cooper.)

- March 9, 2020: the banking regulators issued a joint statement to encourage depository institutions to meet the financial services needs of their customers and members in COVID-19-affected areas.

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- March 13: each of the banking regulators issued guidance identifying efforts to work with customers by waiving fees, offering repayment accommodations, extending payment due dates, increasing credit card limits, and increasing ATM withdrawal limits.
- March 19, 2020: the banking regulators issued a new statement encouraging depository institutions to continue working with affected customers and communities—particularly those that are low- and moderate-income—by providing favorable consideration for those activities pursuant to the Community Reinvestment Act (CRA).
- March 22, 2020: each of the banking regulators issued an interagency statement to allow banks to provide certain modifications to loans without designating them as a troubled debt restructurings (TDRs). Under accounting principles, a TDR designation could have negative consequences for a bank's financial and regulatory reporting requirements.

Regulatory Adjustments

Because banks are vital to the economy's functioning, the government has created taxpayer-backed "safety nets" to prevent them from failing and to protect depositors. To reduce the likelihood that these safety nets need to be used, regulatory agencies have implemented "safety and soundness" regulations, which include rules related to banks' capital and liquidity. Bank regulators also have the authority to supervise banks, which includes examinations and off-site monitoring, to ensure they are well run and following these rules. In response to COVID-19, bank regulators have made certain adjustments to banking regulation and supervision.

Capital allows a bank to withstand unanticipated losses, up to a point, without failing. Unlike liabilities, which place specific and inflexible payment obligations on a bank, the value of bank capital can be written down in the event of unexpected losses. To reduce the likelihood of bank failures, regulators require banks to hold certain minimum amounts of capital to absorb losses and liquid assets to meet obligations. The value and riskiness of a bank's assets and its size determines how much capital and liquidity it must hold. In addition, banks must hold certain amounts of capital over the minimums, called buffers, to avoid restrictions on capital distributions, such as dividends. Certain large banks also are required to hold liquidity buffers. Most banks elect to hold buffers in excess of any requirement to ensure they stay above minimums and distribution restriction thresholds in the event of an economic downturn.

If COVID-19 causes borrowers to miss payments—which seems likely in light of the drastic reduction in economic activity—it would cause banks to incur losses and draw down their capital. If at the same time, individuals and businesses are withdrawing savings, it could strain bank liquidity. This is why capital and liquidity requirements are in place; so that banks have enough cushion that they are likely to survive such events. However, as the buffers are depleted and capital levels get closer to minimums, banks could respond by making fewer or no new loans because those new assets would increase the amount of capital the bank had to hold. This in turn would decrease the amount of credit available in the economy, potentially hastening, deepening, or causing a recession. Bank regulators have taken steps to reduce the likelihood that occurs.

As part of a March 17 announcement, bank regulators released a statement encouraging banks to use their capital and liquidity buffers to support continued lending. On March 19, the agencies released a clarification on the buffer statement that included a Q&A document. These guidance documents remind banks that the purpose of the buffers is to ensure banks can keep lending during distressed times, note how much capital and liquidity are currently in the bank system, and encourage banks to continue lending prudently.

Bank regulators also issued a rule change to how capital is measured to make it easier for banks to comply with capital rules that can place restrictions on a bank's dividend payments and other capital

distributions. Under this new rule, banks have an option to count more of their net income from the past year as "eligible retained earnings" that count toward meeting capital requirements. On March 23, the Federal Reserve announced the new definition would also be applied to the total loss-absorbing capacity rules that the largest U.S. banks and U.S. operations of foreign banks face. The rules require those banks to hold certain types and amounts of capital and debt. On March 24, the Federal Reserve announced that it would delay the upcoming implementation of a rule that would change the methodology used to determine how much liquidity the U.S. operations of foreign banking organizations have through temporary overdrafts on their Federal Reserve accounts, citing changing priorities stemming from the pandemic. The effective date was rescheduled from April 1 to October 1. In addition, the Federal Reserve has encouraged banks that need liquidity to borrow from its discount window. Recent actions taken by the Federal Reserve to provide liquidity to financial markets in response to COVID-19 are covered in CRS Insight IN11259, *Federal Reserve: Recent Actions in Response to COVID-19*, by Marc Labonte.

On March 24, the Federal Reserve announced adjustments to its supervisory activities and priorities in response to the uncertainties created by COVID-19. Broadly, the Federal Reserve is shifting focus away from examination in favor of monitoring. It will cease all examinations of institutions with less than $100 billion, except in cases where there is "urgent need." Certain examination activities will be deferred at institutions with more than $100 million. The Federal Reserve's focus will instead shift to monitoring efforts to understand "the challenges and risks that the current environment presents."

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