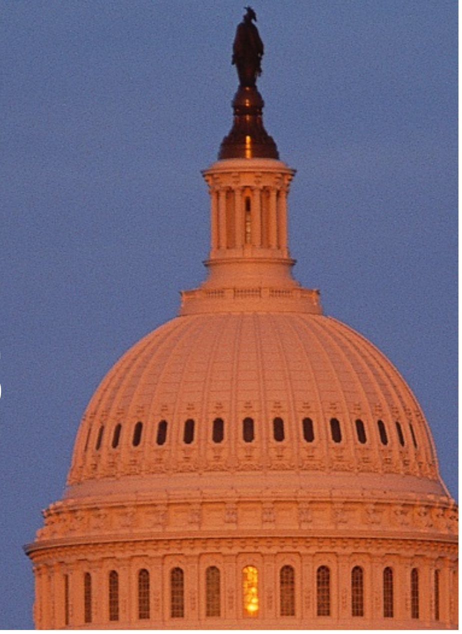
Regulatory Alert for Financial Services

Regulatory Insights



March 2020

CARES Act: Financial Services Impacts

The CARES Act is intended to help mitigate financial services providers' retail and commercial losses and repayment risks. The Act comes at a time of incredible staffing and capacity strain to service and operational centers in terms of transactions, customer calls, and trading volumes, which will likely increase as the servicing and default activity increases. There will be both direct and indirect portfolio implications to financial services organizations given the pandemic implications across all industries. As such, the Act also looks to add to credit and liquidity facilities, while also allowing for potential short-term financial services regulatory relief.

KPMG's view, based on lessons learned following the 2008 financial crisis, would suggest that financial institutions will need to focus on such areas as credit modeling, operational and compliance execution of loan modification programs, adherence to federal program integrity, and fraud mitigation and alert risk activity. Regulators and financial institutions anticipate impacts from certain of the relief provisions will likely need additional policy steps (such as additional credit facility extensions) to take place in the coming weeks.

The Coronavirus Aid, Relief, and Economic Security Act – or the CARES Act –provides more than $2 trillion in emergency aid to individuals and businesses in various forms including loans, direct payments, and insurance benefits intended to cushion the economic impact of the coronavirus outbreak, or COVID-19.

The following summary looks across key provisions in each of the titles that specifically impact the financial services industry. The areas affected include small businesses, education loans, retirement plans, and mortgage credit.

Title I – Keeping American Workers Paid and Employed Act

Provides $349 billion in direct appropriations for Small Business Administration (SBA) loan guarantees and additional funding for SBA programs and relief to small business borrowers and lenders. Highlights include:

— A new "Paycheck Protection Program" under the SBA's Section 7(a) Loan program. Features include:

  – A maximum loan amount of $10 million (based on payroll costs) and a maximum interest rate of four percent. Allowable uses for the loans would be expanded to include employee salaries, medical leave, insurance premiums, mortgage, rent, and utility payments; the loans will receive a 100 percent government guarantee through December 31, 2020.

  – Expanded eligibility to include certain nonprofits organizations, veterans' organizations, or Tribal businesses as well as sole proprietors and independent contractors. Borrower eligibility would consider whether the borrower was operational on February 15, 2020 rather than repayment ability.

  – Deferred payments of principle, interest, and fees for up to one year.

  – Delegated authority to all current SBA Section 7(a) lenders and lenders who join and make loans under the program.

   - A zero percent regulatory capital risk weight and temporary relief from troubled debt restructuring (TDR) disclosures. *Section 1102.*
   - Limited loan forgiveness for amounts spent on payroll costs, rent and utilities payments, and interest payments on mortgages for borrowers that apply. The amount forgiven will be reduced by any reduction in employees retained. *Section 1106.*
- Expanded eligibility for Economic Injury Disaster Loans (EIDL). *Section 1110.*
- A requirement for the SBA to pay principal, interest, and any associated fees that are owed on existing section 7(a) loans, section 504 loans, or microloan products, for a six month period starting on the next payment due date. Loans on deferment will also receive six months of payment by the SBA, as will loans made up to six months after enactment. Loans provided under the Paycheck Protection Program are not included. Lenders are encouraged to further provide payment deferments and maturity extensions when appropriate. *Section 1112.*
- Increases to the eligibility threshold to file under subchapter V of chapter 11 of the U.S. Bankruptcy Code to include businesses with up to $7.5 million of indebtedness; the increase will terminate after one year. *Section 1113*.

Title II – Assistance for American Workers, Families and Businesses

To provide individuals with additional access to cash, the CARES Act allows individuals to access retirement accounts. Select provisions allow:

- The ten percent early withdrawal penalty to be waived for distributions of up to $100,000 from qualified retirement accounts for coronavirus related purposes made after January 1, 2020. Taxes attributable to coronavirus related distributions would be subject to tax over three years and could be recontributed to an eligible retirement plan within three years.
- Required minimum distribution rules for certain defined contribution plans and IRAs for calendar year 2020 to be waived.

Title III – Supporting America's Health Care System in the Fight Against the Coronavirus

Relief for college students and graduates with outstanding federal debt includes:

- Temporary relief for federal student loan borrowers that permits payments of principal and interest to be deferred for 6 months, through September 30, 2020, without penalty to the borrower for all federally owned loans.
- No penalty for students that fail to complete the semester or term as a result of COVID-19 such that the semester or term that was not completed would not count toward lifetime subsidized loan eligibility; would not be included in the student's Federal Pell Grant Duration limit; and the funds received as Pell grants or federal student loans would not be required to be returned to the Secretary of Education.

Title IV – Economic Stabilization and Assistance to Severely Distressed Sectors of the United States Economy

Provisions in this section are directed toward providing credit and liquidity to small business and the markets. Many are temporary in nature and generally will expire on the earlier of December 31, 2020 or the date on which the national emergency is terminated. Some provisions codify actions taken previously by federal agencies.

Highlights include:

- A total of $500 billion to be provided to the Treasury's Exchange Stabilization Fund (ESF) for loans, loan guarantees, and other investments. The bulk of these funds, $454 billion, will be provided to the Federal Reserve Board (FRB) to support its credit and liquidity facilities for eligible businesses, states, and municipalities.[1] The remainder will be available as direct loans to passenger and cargo air carriers and related businesses, and other businesses deemed important to national security. If those funds are not fully used, the Treasury may make loan and loan guarantees, or other investments in, programs or facilities of the FRB.
   - Lending through any of the FRB facilities must be broad-based, with verification that each participant is not insolvent and is unable to obtain adequate financing elsewhere. Loan forgiveness is not permissible in any such credit facility.

[1] Includes Commercial Paper Funding Facility (CPFF), Primary Dealer Credit Facility (PDCF), Money Market Mutual Fund Liquidity Facility (MMLF), Primary Market Corporate Credit Facility (PMCCF), Secondary Market Corporate Credit Facility (SMCCF), and Term Asset-Backed Securities Loan Facility (TALF).

- Treasury will "endeavor to seek the implementation of a program or facility" through the FRB that provides financing to banks and other lenders that make direct loans to nonprofit organizations and eligible businesses with between 500 and 10,000 employees. The terms would include a requirement that the funds be used to retain at least 90 percent of the organization's workforce. This would be separate from and would not impact the FRB's Main Street Lending Program.
- Direct lending loan terms include sufficient loan security; loan duration of not more than 5 years; stock buyback and dividend restrictions; at least 90 percent retention of March 24, 2020 employment through September 30, 2020; no loan forgiveness; U.S. domiciled business with predominantly U.S. employees. *Section 4003.*

An Office of Inspector General for Pandemic Recovery will be established within the Treasury to conduct, supervise, and coordinate audits and investigations of the making, purchase, management, and sale of loans, loan guarantees, and other investments made by the Treasury Secretary under this Title. *Section 4018.* In addition, a Congressional Oversight Commission will be created; the Commission will terminate on September 30, 2025. *Section 4020.*

— Authority for the FDIC to temporarily establish, through December 31, 2020, a debt guarantee program to guarantee debt of solvent insured depository institutions and depository institution holding companies. Noninterest-bearing transaction account may be treated as a debt guarantee program. Similarly, the NCUA may temporarily increase the share insurance coverage for non-interest-bearing transaction accounts. *Section 4008.*

— Authority for the OCC to temporarily except nonbank financial companies from the OCC's lending limits as well as exempt transactions from the lending limits if they are in the public interest. Temporary relief expires on the earlier of December 31, 2020 or the end of the national emergency. *Section 4011.*

— A requirement that the Community Bank Leverage Ratio for qualifying community banks be reduced from 9 percent to 8 percent via interim final rule expiring on the earlier of December 31, 2020 or the end of the national emergency. *Section 4012.*

— Permissibility for financial institutions, including credit unions, to elect to suspend U.S. GAAP for loan modifications related to COVID-19 that would otherwise be categorized as a troubled debt restructuring. The suspense would apply to loan modifications for loans that were not more than 30 days past due as of December 31, 2019 for the period beginning March 1, 2020 and lasting no later than 60 days after the lifting of the national emergency. *Section 4013.*

— Permissibility for insured depository institutions, including credit unions, bank holding companies, or any of their affiliates to opt to temporarily delay compliance with the FASB Current Expected Credit Losses (CECL) methodology. Such an option will expire at the earlier of December 31, 2020 or the date on which the national emergency is terminated. *Section 4012.*

— Temporary suspension of the statutory limitation on the use of the ESF for guarantee programs for U.S. money market mutual fund industry. *Section 4015*.

— Temporary enhancements to credit union access to the Central Liquidity Facility. *Section 4016*.

— A requirement that furnishers of information to credit reporting agencies who agree to an accommodation on an account of a consumer impacted by COVID-19 to report the account as "current" or as the same status as before the accommodation. Such credit protection is available beginning January 31, 2020 and ending at the later of 120 days after enactment or 120 days after the national emergency is terminated. *Section 4021*.

— A moratorium on foreclosures of federally-backed mortgage loans for not less than 60 days beginning March 18, 2020. *Section 4022.* A moratorium on eviction filings or charges related to nonpayment where the landlord's mortgage is federally-backed. *Section 4024.*

— Temporary forbearance for federally-backed 1-4 family mortgage loans experiencing financial hardship due, directly or indirectly, to COVID-19. Borrowers may request up to 180 days as well as an extension of a second 180 days. *Section 4022.* Temporary forbearance of up to 90 days is also available for federally-backed multifamily mortgage loans, subject to renter protections during the forbearance period including no tenant evictions or late fee charges. *Section 4023*.

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