

Financial Institutions – Regulatory Response and Considerations Related to the COVID-19 Pandemic

APRIL 7, 2020

On March 13, 2020, President Trump declared a National Emergency in response to Coronavirus Disease 2019 (COVID-19). Starting the week prior and continuing to date, federal financial institution regulators and related government agencies have released guidance to address concerns. While we anticipate that there will be further guidance from these regulators and agencies, the below includes current highlights for financial institutions, from both a regulatory and litigation perspective.

Bank Regulatory Developments

Even before the President's National Emergency declaration, bank regulators began issuing guidance. Since then, the pronouncements have come almost daily, including weekends, at the risk of making this report out-of-date soon unless the regulators slow down. As a result, the information contained in this briefing is accurate only as of the date set forth above.

March 9: The federal bank regulators (including the NCUA) and the CSBS issued a pronouncement encouraging financial institutions to meet the financial needs of customers affected by the coronavirus. They urged banks to work constructively with borrowers and other customers in affected communities, and they assured banks that prudent efforts consistent with safe and sound lending practices should not be subject to examiner criticism. They said that regulators will expedite any request to provide more convenient availability of services in affected communities and will work with affected financial institutions in scheduling exams to minimize disruption and burden.

March 15: The Federal Open Market Committee lowered its target range for the federal funds rate to zero to one-quarter percent and announced it would purchase at least \$500 billion in Treasury securities and \$200 billion in agency mortgage-backed securities. It further announced it would reinvest all principal payments from its holdings of agency debt and agency mortgage-backed securities in agency mortgage-backed securities.

That same day, the Federal Reserve Board announced that it was reducing the discount rate by 150 basis points to 25 basis points and that it would permit depository institutions to borrow for up to 90 days from the discount window. Further, it encouraged depository institutions to use intraday credit extended by the Reserve Banks and to use their capital and liquidity buffers as they lend to households and businesses affected by the coronavirus. Finally,

it reduced reserve requirements on deposits to zero percent effective March 26, essentially eliminating reserve requirements.

Also on March 15, the Federal Reserve Board, in coordination with the European Central Bank, the Bank of England, the Bank of Japan, the Bank of Canada, and the Swiss National Bank lowered the pricing on standing U.S. dollar liquidity swap arrangements by 25 basis points and announced that the foreign central banks had agreed to offer U.S. dollars weekly with an 84-day maturity, in addition to the current one-week maturity operations.

March 16: The federal banking regulators expressly encouraged banks to use the Federal Reserve discount window.

March 17: The Federal Reserve Board launched a \$10 billion commercial paper funding facility, the bank regulators again publicly urged banks to work with affected customers, and the Federal Reserve Board announced a primary dealer (firms that buy U.S. Treasury securities directly from the U.S.) credit facility

March 18: The Federal Reserve Board announced a money market mutual fund liquidity facility.

March 19: The Federal Reserve Board announced the establishment of a temporary U.S. dollar liquidity arrangement with nine more foreign central banks, and the federal bank regulators announced that they would give Community Reinvestment Act credit for banks that waive late payment fees and increase credit card lines during this crisis.

March 20: The Federal Reserve Board announced that it was expanding its money market mutual fund liquidity facility to accept as eligible collateral short-term (12 months or less) state and municipal debt.

March 22: For the third time, the bank regulators again urged banks to work with customers affected by the coronavirus.

March 23: The Federal Reserve's Federal Open Market Committee announced that it would buy an unlimited amount of Treasury securities and mortgage securities, and the Federal Reserve also announced a technical change to phase in restrictions on firms' "total loss absorbing capacity" buffer requirements if levels decline, intended to allow banks to continue lending to creditworthy borrowers. It also announced six other economic stimulus measures: (1) it will purchase commercial mortgage-backed securities issued by the government-sponsored entities (e.g., FHLMC, FNMA, GNMA); (2) for large employers, it will establish a Primary Market Corporate Credit Facility and a Secondary Market Corporate Credit Facility; (3) it will establish a \$300 billion financing program for employers, consumers, and businesses; (4) it will establish a Term Asset (student loans, auto loans, credit card loans, and SBA loans)-backed Securities Loan Facility; (5) it will expand its Money Market Mutual Fund Liquidity Facility to include variable rate demand notes and bank certificates of deposits as eligible collateral; and (6) it will expand the March 17-announced commercial paper facility to include commercial paper issued by municipal issuers.

The same day, the Governor of New York issued an Executive Order providing that it would be an unsafe and unsound business practice if, in response to the pandemic, any bank subject to the jurisdiction of the New York Department of Financial Services does not grant a forbearance to any person or business who has a hardship as a result of the virus for a period of 90 days. The Order also empowered that Department to restrict ATM fees, overdraft fees, and credit card late fees.

March 24: The New York Department of Financial Services issued emergency regulations requiring New York-regulated banks and mortgage-service entities to make applications for forbearance of any payment due on a residential mortgage of a property located in New York widely available to any New York resident who demonstrates financial hardship as a result of the virus. In addition, such firms are to, subject to safety and soundness requirements, grant such forbearance for 90 days. Those regulations further prohibited applying ATM fees, overdraft fees, and credit card late fees to individuals demonstrating financial hardship from the virus.

Also that day, the Federal Reserve Board provided additional information on how its supervisory approach is adjusting in light of the virus. It said it would monitor and reach out to institutions of all sizes to help understand challenges and risks, and it will temporarily reduce examination activity particularly in the case of the smallest banks. It added that it will grant additional time for resolving non-critical existing supervisory findings.

Issues Affecting Lenders

The impact of COVID-19 has given rise to a plethora of legal documentary issues such as whether the events constitute *force majeure* events under supply contracts and, of specific interest for banks, whether it may constitute a material adverse effect. Loan agreements in the commercial sector will often be conditioned upon there not being a material adverse effect in order for funds to be drawn down under that agreement, and often, loan agreements will contain an event of default should a material adverse effect arise. Many banks are now considering whether COVID-19 would constitute such a material adverse effect.

The general view would seem to be that the banks would have to satisfy a heavy burden of proof in order to demonstrate that the virus would indeed constitute such an event. The effects of the virus are global in nature, and to show that these have a material adverse effect on a specific company, particularly where the events are likely temporary in nature, would likely be difficult. In addition, in the current climate, a lender may be very reluctant to call such an event from a relationship perspective.

Takeaway for Lenders

In the meantime, many borrowers are approaching lenders for relaxation of terms under their loan agreements, be these payment holidays, relaxation of financial covenants, or forbearance in the event that defaults arise under the documents. In many industries such as the transport sector, including aviation and rail, state aid is being considered to rescue ailing companies, and in jurisdictions such as the UK, nationalization of private companies has also been discussed. It will be interesting to see what criteria will be applied if such state aid is provided – will it be a case of survival of the fittest, such that companies that were already ailing should not qualify for such aid?

Anti-Money Laundering and Sanctions Guidance

FinCEN

On March 16, the U.S. Department of the Treasury's Financial Crimes Enforcement Network (FinCEN) released guidance encouraging financial institutions to communicate concerns related to COVID-19 and remain alert for illicit financial activity. In particular, FinCEN encouraged financial institutions to contact FinCEN and federal functional regulators as soon as practicable if there are delays in abilities to file reports with FinCEN (such as Currency Transaction Reports and Suspicious Activity Reports) under the Bank Secrecy Act (BSA).

FinCEN also informed financial institutions to be aware of imposter scams, investment scams, product scams, and insider trading. Finally, FinCEN points financial institutions to FinCEN's advisory, **FIN-2017-A007 "Advisory to Financial Institutions Regarding Disaster-Related Fraud"** (October 31, 2017) for descriptions of other relevant typologies, like benefits-, charities-, and cyber-related fraud.

Takeaway for Financial Institutions

Given the specific warnings FinCEN and other regulators have provided to the financial institution sector, as part of risk monitoring and compliance training, financial institutions should explicitly consider risks posed by scammers, those engaged in insider trading, and those engaged in identity theft.

OFAC

On March 6, the U.S. Department of the Treasury's Office of Foreign Assets Control (OFAC) issued a new **Frequently Asked Questions (FAQs)** related to the provision of humanitarian goods or assistance to Iranian people in response to the COVID-19 outbreak in Iran.

OFAC notes in the newly-issued FAQ (828) that the U.S. persons are generally exempt from making humanitarian donations to recipients in Iran, including the donation of medicine intended to relieve human suffering, under section 31 CFR 560.210(b) of the Iranian Transactions and Sanctions Regulations ("ITSR") provided that such donations are not being made to the Government of Iran or other blocked or designated person. OFAC also notes that persons interested in providing humanitarian assistance to Iran related to the COVID-19 outbreak should review

sections 31 CFR 560.210(b), 560.530, 560.532, and 560.533; General Licenses E and 8; OFAC guidance provided in FAQs 549, 637, 821, 822, 823, and 826; and OFAC guidance provided in “Guidance on the Sale of Food, Agricultural Commodities, Medicine, and Medical Devices by Non-U.S. Persons to Iran” and “Clarifying Guidance on Humanitarian Assistance and Related Exports to the Iranian People.”

Takeaway for Those Seeking to Donate to Iran

While it is clear that the general license for exports of certain agricultural commodities, medicine, and medical devices remains within the ITSR, the practical hurdles in ensuring a transparent and sanctioned-party-free transaction—including within the supply chain, the use of any intermediaries, and potential end-users—remain. Those looking to donate to Iran, and financial institutions processing such transactions, must remain vigilant to ensure no blocked or prohibited financial institutions, freight forwarders, insurers, distributors, and any other parties are involved in the transaction. Financial institutions that permit such transactions should be sure to have robust and clear policies and procedures (including those identifying beneficial ownership of parties to the transaction) related to such transactions.

FINRA Guidance

The Financial Industry Regulatory Authority (FINRA) has also released guidance and a [Frequently Asked Questions page](#) in response to the COVID-19 pandemic.

On March 9, FINRA encouraged member firms to review their business continuity plans (BCPs) under Rule 4370 to ensure that FINRA has a reliable means of contacting the firm in case of an emergency and to assess whether the COVID-19 pandemic constitutes an emergency causing BCP activation. FINRA also noted that if registered representatives are unavailable to service customers, they should promptly place a notice on their website, including who the customer may contact concerning the execution of trades, accounts, and access to funds or securities.

In its March 9 guidance, FINRA also offered suggestions for member firms to mitigate the pandemic’s impact, such as remote work, revised sick-leave policies, and social distancing. FINRA also noted that if member firms opted for remote work, “FINRA would expect that the member firm establish and maintain a supervisory system that is reasonably designed to supervise the activities of each associated person while working from an alternative or remote location during the pandemic.” FINRA also noted that because of this, on-site inspection of branches may be temporarily postponed. Importantly, FINRA advised that if a member firm relocates personnel to a temporary location which is not already registered as a branch office or identified as a non-branch location, the firm should provide written notification to its FINRA Risk Monitoring Analyst as soon as possible.

In its March 9 guidance, FINRA also provided a temporary suspension for updated Form U4s and Form BR applications, and advised its member firms to consider and be prepared for an increased risk of cyber events and attacks.

On March 26, FINRA expanded the guidance related to cybersecurity, detailing measures member firms and associated persons can take to help strengthen cybersecurity controls amongst the COVID-19 pandemic. In particular, FINRA noted that associated persons using office and home networks, should undertake certain measures to protect against cyberattacks such as ensuring they use secure network connections (e.g., Virtual Private Networks), ensuring they use secure Wi-Fi connections with strict security protocols, checking for software updates, changing user names and password equipment, installing anti-virus and anti-malware software, ensuring computer screens are locked while away, and more.

FINRA also alerted member firms to common attacks such as phishing scams that reference COVID-19 or the coronavirus, and malicious links in e-mails and websites – especially those offering “free software.” Finally, FINRA noted that employees should undergo training and awareness on how to connect securely, and ensure that they are aware of who to contact in response to a cybersecurity incident. FINRA will likely continue to provide updated guidance in response to the COVID-19 pandemic, so member firms should be sure to regularly check for updates.

Takeaway for Member Firms

As flagged by FinCEN and FINRA, while the world generally is responding to COVID-19 by engaging in social distancing and remote work environments, nefarious actors are looking to exploit technology gaps. A component of the new temporary work environment is establishing robust policies and procedures to protect data, identities of clients, and the integrity of the underlying transactions, and to ensure the stability overall financial system. Member firms should ensure its personnel are properly trained on how to work in a safe virtual environment, how to detect potential intrusions and fraudulent transactions, and how to report those potential transactions internally and to the regulators.

If you have additional questions or need further assistance, please reach out to Cari Stinebower (cstinebower@winston.com), Dainia Jabaji (djabaji@winston.com), or your Winston relationship attorney.

View all of our COVID-19 perspectives [here](#). Contact a member of our COVID-19 Legal Task Force [here](#).
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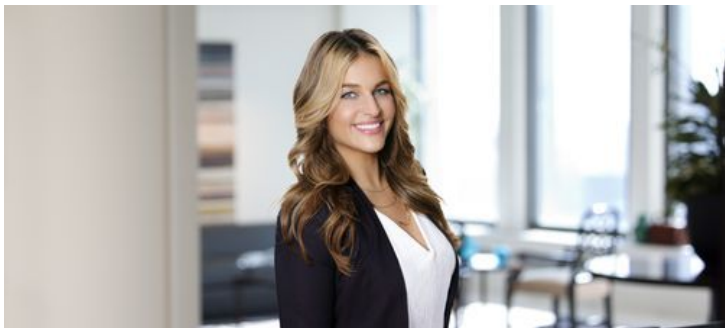
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