Supplement to the FCA Informational Memorandum Providing Guidance for System Institutions Affected by the COVID-19 Pandemic

Regulatory capital requirements for PPP loans and PPP loans pledged to the PPP Liquidity Facility

The Farm Credit Administration issued an informational memorandum on May 4 (PDF) to provide guidance to Farm Credit System (System) institutions on issues related to the COVID-19 pandemic. The memorandum includes guidance for capital requirements. It also states that we will provide additional guidance in the form of supplements to the informational memorandum.

This is the fifth supplement to the May 4 informational memorandum. It discusses the regulatory capital treatment for Paycheck Protection Program (PPP) loans and PPP loans pledged to the Federal Reserve Board's PPP Liquidity Facility (PPPL Facility).[1]

What is the PPP?

Congress created the PPP in section 1102 of the Coronavirus Aid, Relief, and Economic Security Act (CARES Act). PPP loans are fully guaranteed as to principal and accrued interest by the U.S. Small Business Administration (SBA). PPP loans also afford borrowers forgiveness up to the principal and interest amount of the PPP loan, provided the proceeds are used for certain expenses. The SBA reimburses PPP lenders, which include System institutions, for any amount of a PPP loan that is forgiven.

What is the PPPL Facility?

To provide liquidity to small business lenders and the broader credit markets and to help stabilize the financial system, the Federal Reserve Board has created the PPPL Facility using its authority under section 13(3) of the Federal Reserve Act. Under this lending facility, the Federal Reserve Banks will extend nonrecourse loans to institutions that are eligible to make PPP loans. Only PPP 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).[2]

On April 30, 2020, the Federal Reserve Board expanded access to the PPPL Facility to all SBA-qualified lenders, including System institutions (see Paycheck Protection Program Liquidity Facility Term Sheet (PDF)). System institutions that participate in the PPPL Facility should ensure they fully understand the requirements, terms, and conditions of the facility.

---

[1] This guidance is broadly consistent with the federal bank regulatory agencies' interim final rule titled Regulatory Capital Rule: Paycheck Protection Program Lending Facility and Paycheck Protection Program Loans. The rule was issued on April 13, 2020, (85 FR 20387) and corrected on April 21, 2020 (85 FR 22009).

[2] Any such loans pledged to the PPPL Facility cannot be included in a System bank's collateral that is required by section 4.3(c) of the Farm Credit Act.

For more information about the PPPL Facility, see the Frequently Asked Questions on the Federal Reserve's website.

How should a PPP loan be treated for regulatory capital purposes?

Any loan made under the PPP should be risk-weighted at 0% in our risk-based capital calculations.[3] This treatment is consistent with the CARES Act mandate for the risk-based regulatory capital calculations of depository institutions. (See 15 U.S.C. 636(a)(36)(O).)

Any PPP loan that is not pledged to the PPPL Facility should be included in total average assets for purposes of the tier 1 leverage ratio calculation.

When preparing call reports, System institutions should include PPP loan amounts on schedule RC-R.7 (average balances), line 5.a (retail exposures), column D (0%).

How should a PPP loan that is pledged to the PPPL Facility be treated for regulatory capital purposes?

PPP loans pledged to the PPPL Facility should be risk-weighted at 0% for risk-based capital measures and excluded from total average assets for leverage ratio computations. This treatment applies only to the System institution holding the PPP loan on its balance sheet. This means that, if a System association makes a PPP loan and then pledges it to the PPPL Facility, only that association may exclude the pledged loan from its leverage ratio. There will be an impact on the funding bank's regulatory capital ratios only if the association uses the PPPL proceeds to reduce its direct loan from the bank.

When a System institution originates a PPP loan, the loan is an asset on its balance sheet and must therefore be capitalized. If a System institution participates in the PPPL Facility, it pledges the PPP loan to the facility and in return receives cash from the facility, but the pledged PPP loan must still be capitalized by the System institution. In other words, the institution must capitalize both the cash it receives from the PPPL Facility and the PPP loan that was pledged, resulting in an increase in the institution's capital requirements.

While a PPP loan would receive a 0% risk weight and cash would generally receive a 0% risk weight for the purposes of FCA's risk-based capital ratios, both cash and the PPP loan would be included in total average assets for FCA's tier 1 leverage ratio calculation.

The FCA board used its authority under § 628.1(d)(4) to exclude the effects of these pledged PPP loans from System institutions' leverage ratio calculation (including the unallocated retained earnings (URE) and URE equivalents measure). As a result, System institutions may exclude any PPP loan pledged to the PPPL Facility from its tier 1 leverage ratio. This is consistent with the treatment prescribed by the federal banking regulatory agencies in the interim final rule published at 85 FR 20387 (corrected at 85 FR 22009).

When preparing call reports, System institutions may include the PPP loan amounts pledged to the PPPL Facility on schedule RC-R.5 (miscellaneous tier 1/tier2 calculations), line 1.c

[3] The FCA board adopted the 0% risk weight for PPP loans using its authority under § 628.1(d)(3).

(less: other adjustments required by FCA). Including these loan amounts here removes the impact of loans pledged to the PPPL Facility on total average assets for the leverage ratio.

Whom do I contact for more information?

If you have any questions regarding this supplement, please contact Ryan Leist, Senior Accountant, Office of Regulatory Policy, at 703-883-4223 (leistr@fca.gov), or Jeremy R. Edelstein, Associate Director, Office of Regulatory Policy, at 703-883-4497 (edelsteinj@fca.gov).