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Client Alert

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Finalized Liquidity Coverage Ratio

The Board of Governors of the Federal Reserve System (the "Board"), the Federal Deposit Insurance Corporation (FDIC) and the Office of the Comptroller of the Currency (OCC) (collectively, the "agencies") issued the finalized Liquidity Coverage Ratio (LCR) rule yesterday. In October 2013, the agencies issued a notice of proposed rulemaking that provided that covered organizations would need to maintain an amount of high-quality liquid assets (HQLA) equal to those organizations' estimated net cash outflows over a 30-day stressed liquidity period (HQLA, the numerator of the LCR equation, divided by net cash outflows, the denominator, would need to equal 100%). The proposal also provided that HQLA would be divided into three categories, the lower two of which would be assigned haircuts.

The final rule is more liberal than the proposal in a number of ways.

Scope

- The final rule will not cover financial companies designated by the Federal Stability Oversight Council (FSOC) for Board supervision, as the proposed rule intended. Instead, it is recommended that the Board impose enhanced liquidity standards on designated nonbank financial companies after appropriate study of these companies.

- The rule applies to banking organizations with total consolidated assets of $250 billion or more or total consolidated on-balance sheet foreign exposure of $10 billion or more, and any subsidiary depository institutions with $10 billion or more of total consolidated assets ("covered companies").

- A simpler, modified version of the rule applies to depository institutions that are not already covered companies, do not have significant commercial or insurance operations and have $50 billion or more in total consolidated assets ("modified companies").

Effective Dates

- Covered organizations with $700 billion or more in consolidated assets or $10 trillion or more in custodied assets must begin daily LCR calculations on July 1, 2015. Other covered companies have until July 1, 2016 to comply with the daily calculation requirement.

- All covered companies must calculate their LCR at the end of each month starting on January 1, 2015, the effective date of the final rule.

- Modified companies are only required to calculate their LCR at the end of each month, beginning on January 1, 2016.

HQLA

- Corporate debt securities do not need to be publicly traded in order to be considered a level 2B liquid asset, one of the three categories of HQLA, so long as the debt securities are investment grade, demonstrably liquid and not issued by a financial sector company.

- Publicly traded common equity securities in the Russell 1000 Index, instead of only those securities that comprise the S&P 500 Index, are included as level 2B liquid assets.

- Certain secured deposits, such as state, municipal and specified collateralized corporate trust deposits, do not have to be included in the required asset cap and haircut calculations that must take place at the beginning and end of the 30-day stress period.

- While the final rule does not include municipal securities as HQLA, the agencies will continue to review the issue, and a proposal for public comment may result in some municipal securities, with liquidity profiles similar to those of liquid corporate debt securities, being considered HQLA.

Net Cash Outflows

- Calculation mechanics:

  - The final rule eliminates the assumption that outflows with no specified maturity would occur on the first day of the 30-day stress period, and focuses instead on instruments with a contractual maturity and on overnight transactions with financial entities. Net cash outflows will reflect a covered company's highest estimated liquidity need during the 30-day stress period.

- Outflow rate changes:

  - The final rule dictates that the unsecured funding transaction outflow rate for a wholesale counterparty will be the maximum outflow rate for that counterparty, regardless of whether a secured funding transaction outflow rate applies.

  - With respect to special purpose entities, the final rule applies a 100% outflow rate only to special purpose entities that rely on issuing securities or commercial paper for funding.

  - Deposits related to certain collateral and payment processing services provided by covered companies to its customers are considered "operational deposits," and are therefore subject to lower outflow rates. Additionally, deposits that stem from certain custody banking services also benefit from lower outflow rates.

Modified Companies

- The final rule institutes a 30-day stress period with a 70% factor for calculated net cash outflows.

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