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BANKING & FINANCIAL INSTITUTIONS ALERT

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Federal Banking Regulators Finalize Liquidity Rules

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On September 3, 2014, in response to lingering liquidity concerns in the wake of the financial crisis, federal banking regulators finalized their rule requiring the largest U.S. banks to hold enough liquid assets to survive another financial emergency. According to regulators, each institution will be required to hold high quality, liquid assets (HQLA) such as central bank reserves and government and corporate debt that can be converted easily and quickly into cash in an amount equal to or greater than its projected cash outflows minus its projected cash inflows during a 30-day stress period. The ratio of the firm's liquid assets to its projected net cash outflow is its "liquidity coverage ratio," or LCR. The LCR will establish an enhanced prudential liquidity standard consistent with section 165 of the Dodd-Frank Wall Street Reform and Consumer Protection Act. Regulators will also ease calculation requirements for relatively smaller banks covered by the rule, those with assets of between $50 billion and $250 billion, which are subject to a less stringent LCR standard than larger banks. These banks will now only have to calculate their LCR monthly, not daily, and will not have to begin compliance until 2016.

Federal Reserve Chair Janet Yellen commented in a statement that accompanied the rules, “As the financial crisis demonstrated, most of our largest and most systemically important financial institutions used excessive amounts of short-term wholesale funds and did not hold a sufficient amount of high-quality liquid assets to independently withstand the stressed market environment.” Regulators hope the new rules will stabilize banks and help to avoid another economic meltdown and bailout, which cost the taxpayers billions of dollars. However, it is unclear what type of impact the stricter regulations will have on bank business. Requiring banks to acquire and hold onto safer assets could cut into bank’s profit margins as riskier assets often generate increased revenue.

In its joint press release, regulators stated that the rule is generally consistent with the Basel Committee's LCR standard, but is more stringent in certain areas, including a shorter transition period for implementation. The accelerated transition period reflects a desire to maintain the improved liquidity positions that U.S. institutions have established since the financial crisis, in part as a result of supervisory oversight by U.S. bank regulators. U.S. firms will be required to be fully compliant with the rule by January 1, 2017.

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