



BOARD OF GOVERNORS
OF THE
FEDERAL RESERVE SYSTEM
WASHINGTON, D. C. 20551

ADDRESS OFFICIAL CORRESPONDENCE
TO THE BOARD

March 25, 2020

Mr. Joseph M. Otting
Comptroller
Office of the Comptroller of the Currency
400 7th Street SW
Washington, DC 20219

Dear Mr. Otting:

This letter concerns the request by PNC Bank, National Association ("PNC Bank"), Wilmington, Delaware, for an exemption from section 23A of the Federal Reserve Act and the Board's Regulation W to allow PNC Bank to purchase variable-rate demand notes ("VRDNs") from PNC Capital Markets, LLC ("Securities Affiliate"), Pittsburgh, Pennsylvania.

The VRDNs that PNC Bank intends to purchase from Securities Affiliate are issued by municipal entities and include a demand feature that allows investors to put the VRDNs to a tender agent acting for the issuer at par plus accrued interest. The interest rate on the VRDNs generally resets weekly or daily, based on prevailing market conditions and applicable short-term interest rates. As remarketing agent, Securities Affiliate is responsible for reselling to investors the VRDNs that have been tendered for purchase by an investor. If the remarketing is not successful, the VRDN holders are entitled to put the notes back to the tender agent, which could draw on the liquidity facility provided by PNC Bank to repurchase the VRDNs from the holders that are tendering their notes for purchase.

Because of ongoing market disruptions and dislocations in the municipal market and money market mutual funds, PNC Bank represents that the typical liquidity for VRDNs is lacking and Securities Affiliate generally has not been able to remarket the VRDNs successfully. Securities Affiliate has acquired approximately \$ [REDACTED] of VRDNs as an accommodation to its customers to provide liquidity to the municipal VRDN markets, out of a total of \$ [REDACTED] marketed. With the ongoing market dislocations continuing, Securities Affiliate may need to acquire up to a total of \$ [REDACTED] in total of the VRDNs. PNC Bank proposes to purchase from Securities Affiliate up to approximately \$ [REDACTED] in municipal VRDNs, provided (i) the remarketing of the VRDNs fails and (ii) Securities Affiliate decides to purchase the VRDNs to support municipal clients and VRDN market participants.

Section 23A and Regulation W limit the aggregate amount of “covered transactions” between a bank and any single affiliate to 10 percent of the bank’s capital stock and surplus, and limit the aggregate amount of covered transactions between a bank and all its affiliates to 20 percent of the bank’s capital stock and surplus.¹ “Covered transactions” include the purchase of assets by a bank from an affiliate, the extension of credit by a bank to an affiliate, the issuance of a guarantee by a bank on behalf of an affiliate, and certain other transactions.² The statute and regulation also require a bank to secure its extensions of credit to, and guarantees on behalf of, affiliates with prescribed amounts of collateral.³ In addition, section 23A and Regulation W treat a transaction by a member bank with any person as a transaction with an affiliate to the extent that the proceeds of the transaction are used for the benefit of, or transferred to, that affiliate under the “attribution rule.”⁴

A purchase of assets by PNC Bank from Securities Affiliate would be a covered transaction under section 23A and Regulation W. Securities Affiliate is an affiliate of PNC Bank for purposes of section 23A and Regulation W because Securities Affiliate and PNC Bank are under common control of The PNC Financial Services Group (“PNC”), Pittsburgh, Pennsylvania.⁵ In addition, under the attribution rule in section 23A and Regulation W, PNC Bank’s funding of a tender agent’s repurchase of VRDNs from Securities Affiliate through PNC Bank’s liquidity facility also would be a covered transaction.⁶ Moreover, while Securities Affiliate holds the VRDNs, the interest or other payments that Securities Affiliate would receive, which are initially funded by PNC Bank under the liquidity arrangement, would be covered transactions by virtue of the attribution rule. The aggregate amount of the covered transactions would be up to \$ [REDACTED]. This amount would exceed PNC Bank’s quantitative limits under the statute and Regulation W.⁷ Accordingly, PNC Bank is requesting an exemption from the

¹ 12 U.S.C. § 371c(a)(1); 12 CFR 223.11 and 223.12.

² 12 U.S.C. § 371c(b)(7); 12 CFR 223.3(h).

³ 12 U.S.C. § 371c(c); 12 CFR 223.14.

⁴ 12 U.S.C. § 371c(a)(2); 12 CFR 223.16.

⁵ 12 CFR 223.2(a)(2).

⁶ Although the tender agent is an unaffiliated third party, the proceeds of PNC Bank’s loan to the tender agent under the liquidity arrangement are transferred to Securities Affiliate when the trust makes payments to holders of the notes, including Securities Affiliate. As a result, the extension of credit from PNC Bank to the tender agent would be a covered transaction under the attribution rule to the extent that the proceeds are used to make interest and other payments to Securities Affiliate.

⁷ As of December 31, 2019, PNC Bank’s capital stock and surplus was approximately \$ [REDACTED]. Accordingly, for purposes of section 23A and Regulation W, the

quantitative limits of section 23A and Regulation W in connection with the proposed transactions.

Because PNC Bank is a national bank, the Office of the Comptroller of the Currency (“OCC”) may, by order, exempt the proposed investment from the requirements of section 23A if the Board and OCC jointly find the exemption to be (i) in the public interest and (ii) consistent with the purposes of section 23A.⁸ The Board and OCC also must notify the Federal Deposit Insurance Corporation (“FDIC”) of these findings.⁹ The OCC may issue an exemption if the FDIC does not object to the exemption in writing based on a determination that the exemption presents an unacceptable risk to the Deposit Insurance Fund within 60 days of being notified of the OCC and Board’s joint findings.¹⁰

PNC Bank believes that granting the requested exemption would provide public benefits. In particular, PNC Bank has indicated that permitting the proposed transactions with Securities Affiliate would provide an efficient means for Securities Affiliate to help its customers obtain liquidity for VRDNs. A put of the VRDNs to the tender agent would accelerate amortization of the amounts owed under the note and trigger a penalty interest rate, which could add to the stress that municipal entities and VRDN markets are currently experiencing. Permitting PNC Bank to purchase the VRDNs from Securities Affiliate would prevent this additional stress from being added to the municipal entities.

Granting the exemption would not expose PNC Bank to additional credit or market risk. PNC Bank is obligated to advance funds to the tender agents under the terms of the liquidity facility agreements regardless of whether the notes are held or tendered to the tender agents by third-party investors or by Securities Affiliate. If PNC Bank does not purchase the VRDNs and they are put by the investors to the tender agent, then remarketing of the VRDNs would cease, and PNC Bank’s exposure to the municipal entity would be transformed into a loan to the issuer, making PNC Bank’s position less liquid and saleable.

10 percent limit for covered transactions with a single affiliate would be \$ [REDACTED], and the 20 percent limit for covered transactions with all affiliates in the aggregate would be \$ [REDACTED].

⁸ 12 U.S.C. § 371c(f)(2)(B)(i)(I).

⁹ 12 U.S.C. § 371c(f)(2)(B)(ii)(II).

¹⁰ 12 U.S.C. § 371c(f)(2)(B)(i)(II).

Moreover, the exemption from the quantitative limits of section 23A and Regulation W would be subject to the following limits and conditions to help ensure the transactions are consistent with safe and sound banking practices:

- PNC Bank's purchases of assets permitted by this exemption will be conducted at par.
- The total dollar amount of exempt transactions must be limited to \$ [REDACTED].
- PNC Bank's covered transactions not exempted by this order shall continue to meet the quantitative and other restrictions in section 23A and Regulation W.
- PNC Bank's purchases of VRDNs must be consistent with safe and sound banking practices and prudent concentration-risk-management practices.
- The VRDNs purchased by PNC Bank must be investment grade at the time of purchase by the bank as defined in 12 CFR 1.2(d).
- PNC must agree to repurchase from PNC Bank, on a quarterly basis, any assets that (i) fail to continue to be externally rated by a nationally recognized statistical rating organization at single-A or better or the credit equivalent thereof or (ii) become low-quality assets (as defined in Regulation W (12 CFR 223.3(v))) at the price paid by PNC Bank for the assets plus any accrued but unpaid interest.
- PNC and PNC Bank are well capitalized, as defined in the Board's Regulation Y and the OCC's regulations,¹¹ as applicable, at the time of purchase of any of the VRDNs and remain well capitalized so long as PNC Bank continues to hold the VRDNs.
- The exemption is available only for municipal VRDNs acquired by PNC Bank from Securities Affiliate between March 25, 2020, and October 25, 2020, due to the ongoing and potential future dislocation in the municipal market caused by COVID-19.
- The proposed transactions will continue to be subject to the market-terms requirement of section 23B of the Federal Reserve Act.

In light of these considerations, the exemption for the proposed covered transactions between PNC Bank and Securities Affiliate appears to be consistent with the purposes of section 23A and in the public interest. Board staff has consulted with FDIC staff, and the FDIC has not indicated any objection to these findings on the basis of a determination that the requested exemption would present an unacceptable risk to the Deposit Insurance Fund.

This action is specifically conditioned on compliance by PNC and PNC Bank with all the commitments and representations they made to the Board in

¹¹ 12 CFR 6.4 and 12 CFR 225.2(r).

connection with this exemption request. These commitments are deemed to be conditions imposed in writing by the Board in connection with granting the request and, as such, may be enforced in proceedings under applicable law. This determination is based on the specific facts and circumstances described in PNC Bank's correspondence and this letter. Any material change in those facts or circumstances or any failure by PNC or PNC Bank to observe any of their commitments or representations may result in a different conclusion or revocation of the exemption findings.

Very truly yours,

(Signed) Ann E. Misback

Ann E. Misback
Secretary of the Board

cc: Kieran Fallon, Senior Deputy General Counsel, The PNC Financial Services Group, Inc.

Morris Morgan, Senior Deputy Comptroller, Chief Operating Officer, and Chief National Bank Examiner, Office of the Comptroller of the Currency

Jonathan Gould, Senior Deputy Comptroller and Chief Counsel, Office of the Comptroller of the Currency

Nicholas Podsiadly, General Counsel, Federal Deposit Insurance Corporation

Travis Hill, Senior Advisor to the Chairman, Federal Deposit Insurance Corporation