

United States House of Representatives
Committee on Financial Services
2129 Rayburn House Office Building
Washington, D.C. 20515

September 20, 2021

Memorandum

To: Members, Committee on Financial Services
From: FSC Majority Staff
Subject: September 23, 2021, National Security, International Development and Monetary Policy Subcommittee Hearing entitled, “Lending in a Crisis: Reviewing the Federal Reserve’s Emergency Lending Powers During the Pandemic and Examining Proposals to Address Future Economic Crises”

The Subcommittee on National Security, International Development and Monetary Policy will hold a hybrid hearing entitled, “Lending in a Crisis: Reviewing the Federal Reserve’s Emergency Lending Powers During the Pandemic and Examining Proposals to Address Future Economic Crises” on Thursday, September 23, 2021, at 10:00 AM in room 2128 of the Rayburn House Office Building and via Cisco Webex. There will be one panel with the following witnesses:

- **The Honorable Shawn Wooden**, Treasurer, State of Connecticut
- **Mike Konczal**, Director, Macroeconomic Analysis and Progressive Thought, Roosevelt Institute
- **June Rhee**, Director Master of Management Studies in Systemic Risk, Yale School of Management
- **Christopher Russo**, Post-Graduate Research Fellow, Mercatus Center
- **Claudia Sahm**, Senior Fellow, Jain Family Institute

Background

The COVID-19 pandemic triggered an unprecedented economic downturn in the United States. In February 2020, signs began to emerge that the COVID-19 virus would have severe public health consequences around the world, leading to significant turmoil in financial markets, and raising concerns about an imminent financial crisis that would necessitate emergency action by the Board of Governors of the Federal Reserve System (Fed) in its capacity as the “lender of last resort.”¹ The Fed acted quickly to cut its primary interest rate and re-establish bond purchasing programs set up during the Great Recession. In mid-March 2020, Fed Chair Jerome Powell directed staff to begin exploring what emergency lending programs could be developed to stabilize financial markets.²

Recognizing the danger of severe long-term damage to the economy, the Fed announced the formation of several lending efforts to provide credit to a wide selection of borrowers in both the private and public sectors. On March 23, 2020, the Fed announced the Primary Market Corporate Credit Facility (PMCCF), which was intended to purchase new bonds from eligible corporations, and the Secondary Market Corporate Credit Facility (SMCCF), which was intended to be a liquidity backstop in the secondary corporate bond market.³ Through the Coronavirus Aid, Relief, and Economic Security Act

¹ New York Times, *The Financial Crisis the World Forgot*, (March 16, 2021).

² *Id.*

³ Fed, *Federal Reserve announces extensive new measures to support the economy*, (Mar. 23, 2020)

(CARES Act), Congress provided \$454 billion in funds to the Treasury Department to set up emergency lending facilities that would direct support to small businesses and municipalities. On April 9, 2020, the Fed announced that it would establish additional facilities to provide loans to municipal borrowers and purchase loans made to small and mid-sized businesses by establishing the Municipal Liquidity Facility (MLF) and the Main Street Lending Program (MSLP).⁴ Of the 13 emergency lending facilities the Fed eventually established to combat the financial fallout caused by COVID-19, nine (including the SMCCF, the MLF, and the MSLP) were supported with CARES Act funds.⁵ The CARES Act-funded facilities were all terminated by early January 2021, though several of the other facilities, like the Paycheck Protection Program Liquidity Facility (PPPLF), were closed several months later.⁶

Section 13(3) of the Federal Reserve Act

The Fed derives its authority to support corporations and other non-member banks of the Federal Reserve System from Section 13(3) of the Federal Reserve Act. Section 13(3) can only be invoked during “unusual and exigent circumstances” by a consenting vote of at least five of seven members of the Federal Reserve Board of Governors.⁷ Section 13(3) was last invoked during the 2008 financial crisis, when the Fed took extraordinary action to assist firms whose failure would amplify systemic risks.⁸ Concerns were raised that the Fed was inappropriately bailing out individual firms, like Bear Stearns and AIG, while Fed officials said they only did so because there was no legal mechanism at the time to safely unwind a systemic financial firm.⁹ In response, Congress passed the Dodd–Frank Wall Street Reform and Consumer Protection Act, which established an orderly liquidation authority for systemic firms, and reformed the Fed’s 13(3) powers in several ways: by requiring that the Treasury Secretary approve all 13(3) actions, by requiring that all emergency lending establish “broad-based eligibility,” and by prohibiting lending to insolvent institutions.

Secondary Market Corporate Credit Facility (SMCCF)

The SMCCF purchased existing corporate bonds that were trading in the secondary corporate bond market. The Fed aimed to inject liquidity and instill confidence that demand would exist for newly issued corporate debt. The SMCCF originally only purchased bonds issued by companies that were rated investment grade (BBB-, Baa3) by a nationally recognized statistical rating organization. On April 9, the Fed expanded the eligible universe of bonds to include companies that were rated as investment grade on March 22, 2020 but were downgraded to at least BB-/Ba3 on the date that the SMCCF purchased a bond.¹⁰ The SMCCF purchased bonds at fair market value.¹¹ The SMCCF used two methods to purchase bonds: (1) by purchasing shares of exchange-traded funds (ETFs) that included a broad range of investment-grade bonds and bonds that had been subsequently downgraded to BB-/Ba3, and (2) by purchasing bonds from a market index created by the Fed that included bonds that were eligible for purchase, which the Fed recalculated every 4-5 weeks.¹² The SMCCF began purchasing shares of ETFs on May 12, 2020 and began purchasing individual bonds via the SMCCF index on June 16, 2020. It ceased purchasing bonds on December 31, 2020. As of August 31, 2021, the holdings of the SMCCF had been sold or matured.¹³

⁴ Department of the Treasury, [Treasury and Federal Reserve Board Announce New and Expanded Lending Programs to Provide up to \\$2.3 Trillion in Financing](#), (Apr. 9, 2020)

⁵ See GAO, [Report to Congress on Federal Reserve Lending Programs](#) (December 2020), and CRS, [The Federal Reserve’s Response to COVID-19: Policy Issues](#) (Feb. 8, 2021)

⁶ *Id.*

⁷ Federal Reserve Bank of New York, [The Political Origins of Section 13\(3\) of the Federal Reserve Act](#), (Sept. 2018)

⁸ CRS, [Federal Reserve: Emergency Lending](#), (Mar. 27, 2020).

⁹ Former Fed Chair Ben Bernanke, [Warren-Vitter and the lender of last resort](#) (May 15, 2015).

¹⁰ Federal Reserve Board of Governors, [Secondary Market Corporate Credit Facility Term Sheet](#), (Apr. 9, 2020)

¹¹ Federal Reserve Bank of New York, [FAQs: Secondary Market Corporate Credit Facility](#), (Jul. 8, 2021)

¹² Federal Reserve Bank of New York, [Composition of the SMCCF Broad Market Index](#), (Jan. 11, 2021).

¹³ Federal Reserve Bank of New York, [Secondary Market Corporate Credit Facility](#), (Mar. 1, 2021).

In total, the SMCCF purchased \$13.8 billion in bonds and ETF shares.¹⁴ The Primary Market Credit Facility did not initiate any purchases.

Municipal Liquidity Facility (MLF)

The MLF purchased bonds directly from municipal issuers. Entities that were eligible to participate in the MLF included all 50 states and Washington, D.C., cities with a population greater than 250,000 and counties with a population greater than 500,000. Additionally, each state could designate up to two revenue-bond issuers.¹⁵ The MLF was authorized to purchase several municipal notes with maturity dates of no longer than three years, including tax anticipation notes, tax and revenue anticipation notes, bond anticipation notes, and revenue anticipation notes.¹⁶ Interest rates on MLF purchases were calculated by using a comparable maturity overnight index swap (OIS) rate and adding a spread based on the issuer's credit rating.¹⁷ The Fed set these terms in accordance with rules adopted by the Fed in 2016, which specify that "emergency loans would only be made at a penalty rate that exceeds the market rate for such loans."¹⁸ The MLF purchased a total of \$6.4 billion in municipal bond notes from two issuers: the state of Illinois and New York's Metropolitan Transportation Authority.¹⁹ The MLF ceased purchasing bonds on December 31, 2020.

Main Street Lending Program (MSLP)

The MSLP was intended to provide credit to small- and medium-sized businesses that were financially stable before the COVID-19 pandemic. MSLP loans were available for U.S. businesses that had up to 15,000 employees or earned less than \$5 billion in revenue in 2019.²⁰ MSLP was divided into three facilities with different eligibility criteria: (1) the New Loan Facility, which offered loans between \$100,000 and \$35 million to borrowers with debts not exceeding 4 times their 2019 earnings before interest, taxes, depreciation, and amortization (EBITDA); (2) the Priority Loan Facility, which offered loans between \$100,000 and \$50 million to borrowers with debts not exceeding 6 times their 2019 EBITDA, and which borrowers could use to refinance existing debt owed to another lender.²¹; and (3) the Expanded Loan Facility, which offered loans between \$10 million and \$300 million to borrowers with debts not exceeding 6 times their 2019 EBITDA.²² However, the MSLP evolved with time. For example, the minimum loan amount was originally \$1 million before it was later reduced to \$500,000, then \$250,000, and eventually \$100,000.²³

MSLP loans were processed by banks and credit unions and later purchased by a special purchase vehicle established by the Federal Reserve Bank of Boston.²⁴ After a loan was finalized, the Fed purchased 95% of the loan and the lender retained 5% of the underlying loan.²⁵ Each facility offered 5-year loans with adjustable interest rates of LIBOR+3%, with interest deferred for one year and principal payments deferred for two years.²⁶ Additionally, MSLP loans required borrowers to comply with several terms, including, "commercially reasonable efforts to maintain its payroll and retain its employees," and restrictions in the CARES Act that established limitations on stock repurchases, dividend distributions,

¹⁴ Fed, [Update on Outstanding Lending Facilities Authorized by the Board under Section 13\(3\) of the Federal Reserve Act](#), May 9, 2021

¹⁵ Pew, [The Municipal Liquidity Facility: How It Works](#), (Oct. 12, 2020)

¹⁶ Federal Reserve Bank of New York, [FAQs: Municipal Liquidity Facility](#), (Oct. 5, 2020)

¹⁷ Fed, [Municipal Liquidity Facility Term Sheet](#), (Aug. 11, 2020)

¹⁸ Fed, [Extensions of Credit by Federal Reserve Banks](#), (Jan. 1, 2016.)

¹⁹ CRS, [The Federal Reserve's Response to COVID-19: Policy Issues](#), (Feb. 8, 2021)

²⁰ CRS, [The Federal Reserve's Main Street Lending Program](#), (Nov. 4, 2020)

²¹ Fed, [Term Sheet: Main Street Priority Loan Facility](#), (Jun. 8, 2020)

²² Fed, [Uptake of the Main Street Lending Program](#), (Apr. 16, 2021)

²³ Wall Street Journal, [Fed Again Eases Terms for Main Street Lending Program](#) (Oct. 30, 2020).

²⁴ Fed, [Main Street Lending Program](#), (Jan. 8, 2021).

²⁵ Federal Reserve Bank of Boston, [Main Street Lending Program FAQs](#), (Dec. 29, 2020).

²⁶ CRS, [The Federal Reserve's Main Street Lending Program](#), (Nov. 4, 2020).

and executive compensation.²⁷The MSLP purchased 1,830 loans totaling \$17.5 billion, with more than 70% of purchases (\$12.9 billion) facilitated out of the Priority Loan Facility.²⁸ The New Loan Facility accounted for \$2.7 billion in transactions and the Expanded Loan Facility accounted for \$1.8 billion in transactions.²⁹ The MSLP stopped purchasing eligible loans from each facility on January 8, 2021.

Impact of the Fed’s Emergency Lending Facilities

The SMCCF, MLF, and MSLP distributed about \$38 billion out of \$1.7 trillion that was authorized by the Fed, totaling less than 2.3% between all three facilities.³⁰ Though uptake was small, each facility had notable effects on markets. According to an analysis by the Government Accountability Office (GAO), conditions in credit markets improved considerably after the establishment of the emergency lending facilities, with bond issuances returning to previous highs, and spreads returning to sustainable rates after temporarily spiking to levels that reflected a belief that borrowers would be unable to repay loans.³¹ Various scholars have found that the Fed’s SMCCF announcement on March 23 helped calm the secondary bond market.³² Issuers with below-investment grade credit ratings who were initially excluded from SMCCF saw an increase in credit spreads by about 340 basis points after the March announcement, but the April 9 announcement regarding the expansion to issuers who had been downgraded after March 23 (“fallen angels”) saw that effect reversed by about 250 points.³³ Researchers attribute these effects as the SMCCF helping calm a hectic secondary corporate bond market in March-April 2020.³⁴

In an analysis of the MLF, researchers from the Fed found that the MLF had a similar effect, with investment-grade municipal bonds sharply rising in March 2020, but returning to pre-pandemic levels by June.³⁵ New issuances from municipalities in March 2020 fell by 31% compared to 2019, followed by a 4% dip in April 2020 and a 1% dip in May 2020. By June 2020, new municipal issuance volume exceeded 2019 levels by 34%.³⁶ By the end of 2020, total municipal issuance reached an all-time high of \$475.5 billion.³⁷ One estimate found that on average the MLF helped narrow credit spreads of municipal bonds by about 110 basis points, suggesting that the MLF was a useful tool despite the limited uptake.³⁸ In a review of the MSLP, economists from the Federal Reserve Bank of Boston found that the MSLP assisted a wide range of struggling sectors, including food services, manufacturing, real estate, rental and leasing, mining, and oil and gas extraction.³⁹ Further data indicated that the facility’s eligibility criteria may have prevented highly leveraged firms from having access to government capital.⁴⁰ When comparing MSLP uptake to loans made by lenders to borrowers with identical eligibility criteria (but were not sold to MSLP), Fed researchers found that, “Main Street lending volume over its lifespan was about 60 percent of the volume of comparable loans made outside the program by large banks.”⁴¹ MSLP volume measured against non-MSLP volume suggests that the program was an important lending resource for small-and-medium-sized businesses during 2020.⁴²

²⁷ CRS, [Restrictions on Compensation Under the CARES Act](#), (Jun. 12, 2020).

²⁸ Fed, [Uptake of the Main Street Lending Program](#), (Apr. 16, 2021)

²⁹ Id.

³⁰ Fed, [Reports to Congress Pursuant to Section 13\(3\) of the Federal Reserve Act in response to COVID-19](#) (Sep. 20, 2021)

³¹ Government Accountability Office, [Federal Reserve Lending Programs](#), (Dec. 31, 2020).

³² Li and Monim, [The Causal Effect of the Fed’s corporate credit facilities on eligible issuer bonds](#), (Sept. 3, 2020); and Gilchrist, Wei, Yu, and Zakrajsek, [The Fed Takes on Corporate Credit Risk: An analysis of the efficacy of the SMCCF](#), (Sept. 2020).

³³ Id.

³⁴ Id.

³⁵ Federal Reserve Bank of New York, [Municipal Debt Markets and the COVID-19 pandemic](#), (Jun. 29, 2020).

³⁶ CRS, [COVID-19: The Federal Reserve’s Municipal Liquidity Facility](#), (Aug. 14, 2020)

³⁷ Federal Reserve Bank of Cleveland, [Municipal Markets and the Municipal Liquidity Facility](#), (Mar. 22, 2021)

³⁸ Federal Reserve Bank of Chicago, [The Impact of the Pandemic and the Fed’s Muni Program on Illinois Yields](#), (Dec. 2020).

³⁹ Bräuning and Paligorova, [Uptake of the Main Street Lending Program](#), (Mar. 19, 2021)

⁴⁰ English and Liang, [Designing the Main Street Lending Program: Challenges and Options](#), (Jun. 18, 2020).

⁴¹ Bräuning and Paligorova, [Uptake of the Main Street Lending Program](#), (Mar. 19, 2021)

⁴² Id.

Criticism of Emergency Lending Facilities

Although the Fed’s facilities were useful in improving conditions in financial markets, they did not prevent the devastating impact that the pandemic had on the labor market. Nationwide business closures resulted in extended layoffs and job losses, resulting in the April 2020 unemployment rate reaching 14.8% – the highest rate calculated since the Bureau of Labor Statistics began tracking the statistic in the 1940s.⁴³ With corporate bond markets unfrozen, businesses were able to borrow without accepting the workforce maintenance requirements or other restrictions that were applied to several CARES Act programs designed to assist businesses.⁴⁴ In one example, Boeing used the corporate bond market rather than accepting aid that had been set aside for it in the CARES Act, then laid off workers.⁴⁵ Still, other companies reported being able to keep workers on their payroll because of the “lifeline” the Fed had extended to the corporate bond market.⁴⁶

Some criticized the Fed’s facilities for offering more generous support to larger corporations and financial institutions than to municipalities and smaller entities.⁴⁷ The SMCCF’s format faced criticism for purchasing bonds at fair market value instead of at a penalty rate, which some argued was more generous to businesses than to households.⁴⁸ The MLF faced pushback from lawmakers and municipal borrowers who argued that the facility’s terms were too restrictive to be useful to many states and cities.⁴⁹ In Congressional Oversight Commission hearings, Democratic lawmakers argued that reducing the facility’s penalty rate could make the program more attractive for borrowers, while Kent Hiteshew, the Deputy Associate Director for the Division of Financial Stability at the Federal Reserve, insisted that the facility’s purpose was to serve as a backstop and not to compete with lenders in the private markets.⁵⁰ Similarly, the National Association of Counties urged the Treasury Department and the Fed to consider expanding the repayment terms to 10 years and to possibly create a vehicle to purchase municipal bonds in the secondary market.⁵¹ The MSLP faced some criticism from both borrowers and lenders who were uncertain about the program’s eligibility criteria and loan terms, and disappointed by the Fed’s communication strategy.⁵² For example, press reports detailed a lack of interest among banks willing to participate in the program, which could have contributed to the program’s modest usage.⁵³ The Federal Reserve Bank of Boston’s President Eric Rosengren recommended that loosening MSLP loan terms could lead to more usage.⁵⁴

Legislation

- **H.R. _____, the “National Investment Authority Act,”** which is a discussion draft to establish a National Investment Authority (NIA) to support and coordinate long-term infrastructure investments. The proposal would empower the NIA’s National Capital Management Corporation arm to coordinate the government’s management of economic crises and sectoral distress in a manner that protects workers, mitigates financial stability risks, and encourages long-term benefits from investment of public money toward private institutions.

⁴³ CRS, [Unemployment Rates During the COVID-19 Pandemic](#). (Aug. 20, 2021)

⁴⁴ Bloomberg, [Fed Vow Boosts Debt Binge While Corporations Cut Thousands of Jobs](#). (Jun. 5, 2020).

⁴⁵ Bloomberg, [Boeing Rules Out Federal Aid After \\$25 billion of bonds](#). (Apr. 30, 2020).

⁴⁶ Bloomberg, [Fed Vow Boosts Debt Binge While Corporations Cut Thousands of Jobs](#). (Jun. 5, 2020).

⁴⁷ Congressional Oversight Commission, [Fifth Report of the Congressional Oversight Commission](#). (Oct. 15, 2020).

⁴⁸ New York Times, [The Fed Announces Plans to Sell Off its Corporate Bond Holdings](#). (Jun. 2, 2021).

⁴⁹ Yale Program on Financial Stability, [Disagreements over the Municipal Liquidity Facility Erupt](#). (Oct. 7, 2020).

⁵⁰ Congressional Oversight Commission, [The Fifth Report of the Congressional Oversight Commission](#). (Oct. 15, 2020)

⁵¹ NACo, [Congressional Oversight Commission \(COC\) Releases New Report on Municipal Liquidity Facility](#). (Oct. 21, 2020)

⁵² New York Times, [Oversight Member Blasts the Fed’s Efforts to Rescue Main Street](#). (Aug. 7, 2020).

⁵³ Politico, [Businesses blast key Fed program, saying banks not interested in lending](#). (Aug. 7, 2020).

⁵⁴ Washington Post, [Congress needs to weigh in on expanding Main Street loan program to more businesses](#). (Sept. 8, 2020).