MAXINE WATERS, CA
CHAIRWOMAN

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

PATRICK MCHENRY, NC
RANKING MEMBER

June 12, 2020

Memorandum

To: Members, Committee on Financial Services
From: FSC Majority Staff
Subject: June 17, 2020, "Monetary Policy and the State of the Economy"

The Committee on Financial Services will hold a virtual hearing entitled, "Monetary Policy and the State of the Economy," on Wednesday, June 17, 2020, at 12:00 p.m., on the virtual meeting platform Cisco Webex. Chairman of the Board of Governors of the Federal Reserve System, Jerome Powell, will be the sole witness. There is a hard stop at 3:00 p.m.

Purpose and Background
The Federal Reserve Act (FRA) directs the Chairman of the Board of Governors of the Federal Reserve System (Board) to testify before the House Committee on Financial Services and the Senate Committee on Banking twice a year on how the Board handles monetary policy and its observations on economic developments.[1] Each appearance requires the Board to supply the Committees with a written report known as the *Monetary Policy Report*.[2] For more background on the Federal Reserve System's structure and its conduct of monetary policy, see the Financial Services Committee memo prepared for the "Monetary Policy and the State of the Economy" hearing from February 2020.[3]

Monetary Policy and Labor Market Conditions during the COVID-19 pandemic
After supply side shocks from the COVID-19 outbreak caused financial market turmoil, the Federal Open Market Committee (FOMC) made an announcement on March 3 in between its previously announced meetings that it would reduce the federal funds rate by fifty basis points. On March 15, 2020, the FOMC made its second announcement in two weeks, cutting the overnight interest rate 1 percent, to a range between 0 and 0.25 percent (also called the "zero lower bound"). The FOMC also announced on March 15 that it would make large scale asset purchases (LSAPs) of $500 billion in Treasury securities and of at least $200 billion in agency mortgage-backed securities issued by Fannie Mae, Freddie Mac, and Ginnie Mae (agency MBS) over the next few months. On March 23, the Fed announced that it would expand its purchases of Treasury securities and agency MBS to an unspecified amount "to support smooth market functioning and effective transmission of monetary policy to broader financial conditions and the economy," and would for the first time purchase agency commercial MBS (CMBS) issued by Fannie Mae, Freddie Mac, and Ginnie Mae.

---

[1] The Federal Reserve Act of 1913, Pub. L. No. 63-43, 38 Stat. 251.
[2] For the current Monetary Policy Report, see: https://www.federalreserve.gov/monetarypolicy/mpr_default.htm.
[3] "Monetary Policy and the State of the Economy," *House Financial Services Committee*, (February 11, 2020), https://docs.house.gov/meetings/BA/BA00/20200211/110485/HHRG-116-BA00-20200211-SD002.pdf.

The immediate impact of COVID-19 on the economy has been severe; in April, the Bureau of Labor Statistics (BLS) published the worst jobs report in its recorded history, with 20.5 million jobs lost, wiping out more than a decade of job growth from the Great Recession in a single month.[4] In an April 29 press conference, Chair Powell acknowledged the disproportionate impact of the employment situation on communities of color, saying, "[Only two months ago,] we were hearing from minority—low- and moderate-income and minority communities that this was the best labor market they'd seen in their lifetime. All the data supported that as well. And it is heartbreaking, frankly, to see that all threatened now." Powell has also emphasized numerous times that the long-term outlook of the economy will depend on the success of efforts to contain the virus[5], stressing that "a full recovery is unlikely to occur until people are confident that it is safe to reengage in a broad range of activities."[6] Many states and cities have begun allowing businesses to re-open, but the spread of the virus is not yet contained; 14 states and Puerto Rico saw their highest seven-day average of reported new cases during the first week of June.[7] The BLS' May jobs report showed that millions of temporarily laid-off workers had been re-hired, although permanent job losses increased.[8] Powell tempered optimism about the report, noting that unemployment remains "historically high," that the topline 13.3% unemployment rate "likely understates the extent of unemployment," and "the rise in joblessness has been especially severe for lower-wage workers, for women, and for African Americans and Hispanics."[9]

Emergency Lending Prior to the Coronavirus Aid, Relief, and Economic Security (CARES) Act

During the 2008 financial crisis, the Federal Reserve used "emergency lending" authorities granted to it under Section 13(3) of the Federal Reserve Act to rescue AIG and finance JP Morgan's purchase of Bear Stearns. Through the Dodd-Frank Wall Street Reform and Consumer Protection Act, Congress restricted the use of this authority to prohibit lending to insolvent institutions, and also required that emergency lending facilities that are broadly available to institutions, which the Fed interprets to mean that at least five institutions are eligible.[10] The Secretary of the Treasury must also approve the establishment of any 13(3) facility.[11] On March 17, 2020 the Fed began setting up a wide range of facilities utilizing their Section 13(3) lending powers aimed at addressing severe liquidity constraints in financial markets.

Commercial Paper Funding Facility (CPFF): On March 17, the Fed announced the establishment of a CPFF to increase liquidity in the short-term commercial paper market.[12] The commercial paper market is widely utilized by businesses to meet immediate needs like payroll. The Treasury Department provided credit protection using $10 billion from the Exchange Stabilization Fund (ESF).

---

[4] "How Bad is Unemployment? Literally Off the Charts," *New York Times*, (May 8, 2020), https://www.nytimes.com/interactive/2020/05/08/business/economy/april-jobs-report.html.

[5] "Transcript of FOMC Press Conference," *Board of Governors of the Federal Reserve System*, (April 29, 2020), https://www.federalreserve.gov/mediacenter/files/FOMCpresconf20200429.pdf

6 "Transcript of FOMC Press Conference," *Board of Governors of the Federal Reserve System*, (June 10, 2020), https://www.federalreserve.gov/mediacenter/files/FOMCpresconf20200610.pdf

[7] "14 states and Puerto Rico hit highest seven-day average of new coronavirus infections," *Washington Post*, (June 8, 2020), https://www.washingtonpost.com/health/2020/06/08/14-states-puerto-rico-hit-their-highest-seven-day-average-new-covid-19-infections-since-june/

[8] "What to Make of the Rebound in the U.S. Jobs Report," *New York Times*, (June 5, 2020), https://www.nytimes.com/2020/06/05/business/economy/jobs-report.html

[9] "Transcript of FOMC press conference," *Board of Governors of the Federal Reserve System*, (June 10, 2020), https://www.federalreserve.gov/mediacenter/files/FOMCpresconf20200610.pdf

[10] "Federal Reserve: Emergency Lending," *Congressional Research Service*, (March 27, 2020), https://www.crs.gov/Reports/R44185.

[11] Ibid.

[12] "Commercial Paper Funding Facility 2020," *Board of Governors of the Federal Reserve System*, (March 17, 2020), https://www.federalreserve.gov/newsevents/pressreleases/monetary20200317a.htm

Primary Dealer Credit Facility (PDCF): On March 18, the Fed announced a facility to offer support to the large banks and securities broker-dealers known as primary dealers.[13] To further boost liquidity among primary dealers, the Fed expanded the collateral eligible for open market operations to include corporate debt securities, commercial paper, mortgage-backed securities, and more.

Money Market Mutual Fund Liquidity Facility (MMMLF): On March 18, the Fed announced the creation of the MMMLF administered through the Federal Reserve Bank of Boston. The MMMLF lends funds to prime money market funds secured by high-grade collateral, including Treasury securities and top-rated commercial paper, and is shored up through $10 billion from the ESF.

Term Asset-Backed Securities Loan Facility (TALF): On March 23, the Fed announced the re-establishment of the TALF. The TALF supports the asset-backed securities (ABS) market by offering up to $100 billion in liquidity for investment-grade collateral that includes auto loans, student loans, small business loans, and more, though not consumer loans.[14]

Primary and Secondary Market Corporate Credit Facility (PMCCF/SMCCF): On March 23, the Fed also announced a primary and secondary corporate credit facility, which would will provide liquidity to new and existing corporate bond issuances, so long as the bond issuers are rated BBB- or above and the bonds have a maturity of five years or less.[15] To set up these facilities, the Fed announced it would rely on a combined $20 billion equity investment from the ESF, subsequently bolstered with a $75 billion investment in the Coronavirus Aid, Relief, and Economic Security (CARES) Act funds from Treasury.[16] High levels of corporate debt had been repeatedly flagged by the Fed as a financial stability risk in recent years,[17] and press reports in March suggested that "record piles of corporate debt" could become "the next coronavirus financial crisis."[18] As of May 12, the SMCCF is operational and has purchased nearly $1.3 billion in exchange-traded funds and other assets.[19] The PMCCF has not yet purchased any bonds, but the knowledge that it will serve as a backstop has given investors' confidence even during a severe recession, unfreezing corporate debt markets and boosting financial markets. [20] The likelihood that defaults and downgrades could spread risk remains a concern, and the Fed's May 15 financial stability report projected that "corporate default rates were likely to increase sharply, with acute stress in the energy sector."[21]

---

[13] "Term Sheet for PDCF," *Federal Reserve Board of Governors*, (March 18, 2020), https://www.federalreserve.gov/newsevents/pressreleases/files/monetary20200317b1.pdf.

[14] "Term Asset-Backed Securities Loan Facility," *Federal Reserve Board of Governors*, (March 23, 2020), https://www.federalreserve.gov/newsevents/pressreleases/files/monetary20200323b1.pdf.

[15] "Primary Market Corporate Credit Facility," *Federal Reserve Board of Governors*, (March 23, 2020), https://www.federalreserve.gov/newsevents/pressreleases/files/monetary20200323b1.pdf.

[16] "Primary Market Corporate Credit Facility," *Federal Reserve Board of Governors*, (April 9, 2020), https://www.federalreserve.gov/newsevents/pressreleases/files/monetary20200409a5.pdf

[17] "Fed Issues More Warnings of High-Risk Corporate Debt," *Bloomberg*, (May 6, 2019), https://www.bloomberg.com/news/articles/2019-05-06/fed-issues-more-warnings-on-hazards-of-high-risk-corporate-debt

[18] "The next coronavirus financial crisis: Record piles of risky debt," *Wall Street Journal*, (March 19, 2020), https://www.wsj.com/articles/the-next-coronavirus-financial-crisis-record-piles-of-risky-corporate-debt-11584627925

[19] "Update on Outstanding Lending Facilities Authorized by the Board under Section 13(3) of the Federal Reserve Act," *Board of Governors of the Federal Reserve System*, (May 28, 2020), https://www.federalreserve.gov/monetarypolicy/files/pmccf-smccf-talf-5-29-20.pdf#page=2

[20] "Too big to fail: the entire private sector," *New York Times*, (May 19, 2020), https://www.nytimes.com/2020/05/19/business/too-big-to-fail-wall-street-businesses.html

[21] "Financial Stability Report," *Board of Governors of the Federal Reserve System*, (May 15, 2020), https://www.federalreserve.gov/publications/files/financial-stability-report-20200515.pdf

Emergency Lending Facilities Following the CARES Act

On March 27, the CARES Act was signed into law. Section 4003 of the CARES Act creates a $454 billion fund for loans, loans guarantees, and investments through programs and facilities established by the Fed. The CARES Act instructed the Treasury Secretary to work with the Fed to establish facilities supporting state, local, and territorial governments, as well as a facility to support small and mid-sized businesses, as well as non-profit organizations. After the passage of the CARES Act, the Fed announced on April 9 that it would use Section 4003 funds to shore up existing facilities, and create the following new facilities:

Paycheck Protection Program Liquidity Facility (PPPLF): The Federal Reserve established the PPP Liquidity Facility (PPPLF) to provide cash to lenders that post PPP loans as collateral, charging 0.35% for this service. All PPP lenders approved by the Small Business Administration, including all CDFIs and non-depository institution lenders, are now eligible to participate in the PPPLF.

Main Street Lending Program (Main Street or MSLP): The MSLP is designed to support lending to small and medium-sized businesses and is expected to be operational in early June. Treasury will invest $75 billion in the Main Street program to support up to $600 billion in lending. Unlike PPP loans, which can be forgiven, MSLP loans are five-year loans with the principal and interest payments deferred for two years. Eligible banks may originate new Main Street loans or use Main Street loans to increase the size of existing business loans. Banks will retain a 5 percent share, selling the remaining 95 percent to the Main Street facility, which will purchase up to $600 billion of loans. After receiving over 2,000 comments, the Fed announced on April 30 that it would reduce the MSLP's minimum loan size from $1 million to $500,000, allow businesses with up to 15,000 employees and $5 billion in 2019 revenue to participate, and relax restrictions on the use of MSLP loans to refinance existing debt.[22] As the MSLP prepared to become operational in early June, news reports indicated that take-up was expected to be slow because many businesses are finding the terms of the facility unattractive.[23] The Fed announced on June 8 that it would further expand the program, reducing the minimum loan size to $250,000 and raising the maximum loan size to $300 million.[24] The Fed has indicated that it "recognizes the critical role that nonprofit organizations play throughout the economy and is evaluating a separate approach to meet their unique needs,"[25] though it has not yet announced what that approach will be.

Municipal Liquidity Facility (MLF): The MLF was established to support states and cities, with the Treasury Department making a $35 billion investment, enabling up to $500 billion in lending.[26] The Fed has expanded the scope of the MLF twice, first by extending the terms to support bonds with three-year maturities and allowing cities with 250,000 residents and counties with over 500,000 residents, as well as multi-state agencies, to participate directly, then by announcing that states will be able to designate two cities and counties that fall under the population threshold as eligible issuers.[27] Although the CARES Act

[22] "Main Street Lending Program," *Board of Governors of the Federal Reserve System*, (April 30, 2020), https://www.federalreserve.gov/monetarypolicy/mainstreetlending.htm

[23] "Fed's massive 'Main Street' business rescue in danger of fizzling," *Politico*, (June 2, 2020), https://www.politico.com/news/2020/06/02/fed-reserve-main-street-program-297149.

[24] "Main Street Lending Program," *Board of Governors of the Federal Reserve System*, (June 8, 2020), https://www.federalreserve.gov/monetarypolicy/mainstreetlending.htm

[25] "Federal Reserve announces it is expanding scope and eligibility for the Main Street Lending Program," *Board of Governors of the Federal Reserve System*, (April 30, 2020), https://www.federalreserve.gov/newsevents/pressreleases/monetary20200430a.htm.

[26] "Municipal liquidity facility," *Board of Governors of the Federal Reserve System*, (April 9, 2020), https://www.federalreserve.gov/monetarypolicy/muni.htm.

[27] Ibid.

language directing the Fed to support local governments mentioned support for territorial governments, the Fed excluded the territories from the MLF.[28] On May 11, the Fed unveiled the MLF's terms, which include very high penalty rates compared with the other Fed facilities and make the MLF unattractive to all but the lowest investment grade issuers.[29] So far, only Illinois, which has a much lower investment grade than most states and cities, has announced its intention to utilize the MLF.[30]

CARES Act Conditions on Receiving Emergency Loans

The CARES Act requires eligible businesses receiving assistance in the form of direct loans through any Federal Reserve facility to comply with restrictions on stock buybacks, dividend payments, and executive compensation, though the Treasury Secretary has the power to waive those restrictions if he determines that a waiver is "necessary to protect the interests of the Federal Government."[31] Because the Fed interprets the purchase of bonds through its corporate credit facilities to be "securities transactions" rather than "direct loans," the Fed has not applied any CARES Act conditions to the corporate credit facilities. CARES Act restrictions on executive compensation, stock buybacks, and capital distribution have been applied to businesses receiving loans through the MSLP, although participating businesses only need to affirm that they have made "commercially reasonable efforts" to maintain their workforce.[32]

Heroes Act Provisions Related to the Federal Reserve

On May 15, the House of Representatives passed the Heroes Act,[33] which contained several provisions related to the Federal Reserve. The Heroes Act would revise the MSLP by: mandating that nonprofit organizations, including public universities, be eligible for MSLP loans; requiring smaller loan options to help more small businesses; and requiring loan forgiveness for non-profits that predominantly serve low-income communities. The Heroes Act would revise the MLF by: bringing the population threshold for eligible issuers down to 50,000 residents; requiring the inclusion of territories as eligible issuers; eliminating a barrier to participation by striking the requirement that municipalities attest they cannot secure loans in the private market; and extending the maximum maturity for bonds purchased to ten years.

Financial Stability Risks

The Fed recently issued its financial stability report, which focused on continued fallout from the COVID-19 pandemic.[34] The Fed highlighted several key risks to monitor, including elevated leverage at life insurance companies and hedge funds, vulnerabilities in the commercial real estate market, and capital outflows from emerging market economies with persistent account deficits. The report underscored growing concerns about risks where a recession could affect highly leveraged sectors of the economy, and cited concerns related to nonfinancial corporate debt, with a focus on the recent growth in leveraged loans, private credit, and triple-B-rated bonds.[35]

---

[28] Ibid.
[29] Ibid.
[30] "Illinois to sell debt in first deal with Fed's muni liquidity facility," *Reuters*, (June 2, 2020), https://www.reuters.com/article/us-usa-illinois-fed/illinois-to-sell-debt-in-first-deal-with-feds-muni-liquidity-facility-idUSKBN239328
[31] §4003(c)(3)(D)(i) of the CARES Act
[32] "Main Street Lending Program: Frequently Asked Questions," *Board of Governors of the Federal Reserve System*, (June 8, 2020), https://www.federalreserve.gov/monetarypolicy/mainstreetlending.htm
[33] https://financialservices.house.gov/news/documentsingle.aspx?DocumentID=406565
[34] "Financial Stability Report," *Board of Governors of the Federal Reserve System*, (May 15, 2020), https://www.federalreserve.gov/publications/files/financial-stability-report-20200515.pdf.
[35] Ibid.