

Jerome H Powell: Coronavirus Aid, Relief, and Economic Security Act

Testimony of Mr Jerome H Powell, Chair of the Board of Governors of the Federal Reserve System, before the Committee on Banking, Housing, and Urban Affairs, US Senate, Washington, DC, 1 December 2020.

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Chairman Crapo, Ranking Member Brown, and other members of the Committee, thank you for the opportunity to update you on our ongoing measures to address the hardship wrought by the pandemic.

Our public health professionals continue to deliver our most important response, and we remain grateful for their service.

The Federal Reserve, along with others across government, is using its policies to help alleviate the economic burden. Since the pandemic's onset, we have taken forceful actions to provide relief and stability, to ensure that the recovery will be as strong as possible, and to limit lasting damage to the economy.

Economic activity has continued to recover from its depressed second-quarter level. The reopening of the economy led to a rapid rebound in activity, and real gross domestic product, or GDP, rose at an annual rate of 33 percent in the third quarter. In recent months, however, the pace of improvement has moderated.

Household spending on goods, especially durable goods, has been strong and has moved above its pre-pandemic level. In contrast, spending on services remains low largely because of ongoing weakness in sectors that typically require people to gather closely, including travel and hospitality.

The overall rebound in household spending is due, in part, to federal stimulus payments and expanded unemployment benefits, which provided essential support to many families and individuals.

In the labor market, more than half of the 22 million jobs that were lost in March and April have been regained, as many people were able to return to work. As with overall economic activity, the pace of improvement in the labor market has moderated. Although we welcome this progress, we will not lose sight of the millions of Americans who remain out of work. The economic downturn has not fallen equally on all Americans, and those least able to shoulder the burden have been hardest hit. In particular, the high level of joblessness has been especially severe for lower-wage workers in the services sector, for women, and for African Americans and Hispanics. The economic dislocation has upended many lives and created great uncertainty about the future.

As we have emphasized throughout the pandemic, the outlook for the economy is extraordinarily uncertain and will depend, in large part, on the success of efforts to keep the virus in check.

The rise in new COVID-19 cases, both here and abroad, is concerning and could prove challenging for the next few months. A full economic recovery is unlikely until people are confident that it is safe to reengage in a broad range of activities.

Recent news on the vaccine front is very positive for the medium term. For now, significant challenges and uncertainties remain, including timing, production and distribution, and efficacy across different groups. It remains difficult to assess the timing and scope of the economic implications of these developments with any degree of confidence.

The Federal Reserve's response has been guided by our mandate to promote maximum employment and stable prices for the American people, along with our responsibilities to promote the stability of the financial system. We have been taking broad and forceful actions to more directly support the flow of credit in the economy. Our actions, taken together, have helped unlock almost \$2 trillion of funding to support businesses large and small, nonprofits, and state and local governments since April. This, in turn, has helped keep organizations from shuttering and has put employers in both a better position to keep workers on and to hire them back as the economy continues to recover.

These programs serve as a backstop to key credit markets and have helped restore the flow of credit from private lenders through normal channels. We have deployed these lending powers to an unprecedented extent. Our emergency lending powers require the approval of the Treasury and are available only in very unusual circumstances, such as those we find ourselves in today. Many of these programs have been supported by funding from the Coronavirus Aid, Relief, and Economic Security Act (CARES Act), and I have included detailed information about those facilities in my written testimony.

The CARES Act assigns sole authority over its funds to the Treasury Secretary, subject to the statute's specified limits. The Secretary has indicated that these limits do not permit the CARES Act-funded facilities to make new loans or purchase new assets after December 31 of this year. Accordingly, the Federal Reserve will return the unused portion of funds allocated to the lending programs that are backstopped by the CARES Act in connection with their termination at the end of this year. As the Secretary noted in his letter, non-CARES Act funds in the Exchange Stabilization Fund are available to support emergency lending facilities if they are needed.

Everything the Fed does is in service to our public mission. We are committed to using our full range of tools to support the economy and to help assure that the recovery from this difficult period will be as robust as possible on behalf of communities, families, and businesses across the country.

Thank you. I look forward to your questions.

Summary of Section 13(3) Facilities Using CARES Act Funding

The Municipal Liquidity Facility

The Municipal Liquidity Facility (MLF) helps state and local governments better manage the extraordinary cash flow pressures associated with the pandemic, in which expenses, often for critical services, are temporarily higher than normal and tax revenues are delayed or temporarily lower than normal. This facility addresses these liquidity needs by purchasing the short-term notes typically used by these governments, along with other eligible public entities, to manage their cash flows. By addressing the cash management needs of eligible issuers, the MLF was also intended to encourage private investors to reengage in the municipal securities market, including across longer maturities, thus supporting overall municipal market functioning.

Under the MLF, the Federal Reserve Bank of New York lends to a special purpose vehicle (SPV) that will directly purchase up to \$500 billion of short-term notes issued by a range of eligible state and local government entities. Generally speaking, eligible issuers include all U.S. states, counties with a population of at least 500,000 residents, cities with a population of at least 250,000 residents, certain multistate entities, and revenue-bond issuers designated as eligible issuers by their state governors. Notes purchased by the facility carry yields designed to promote private market participation—that is, they carry fixed spreads based on the long-term rating of the issuer that are generally larger than those seen in normal times. With funding from the Coronavirus Aid, Relief, and Economic Security Act (CARES Act), the Department of the Treasury has committed to make a \$35 billion equity investment in the SPV.

The MLF was announced on April 9, 2020, and closed its first transaction on June 5. As of November 25, the facility had purchased two issues for a total outstanding amount of \$1.7 billion.

The MLF has contributed to a strong recovery in municipal securities markets, which has facilitated a historic issuance of approximately \$275 billion of bonds since late March. State and local governments and other municipal bond issuers of a wide spectrum of types, sizes, and ratings have been able to issue bonds, including long maturity bonds, with interest rates that are at or near historical lows. Those municipal issuers that do not have direct access to the Federal Reserve under the MLF have still benefited substantially from a better-functioning municipal securities market.

The Main Street Lending Program

The Federal Reserve established the Main Street Lending Program (Main Street) to support lending to small and medium-sized businesses and nonprofit organizations that were in sound financial condition before the onset of the COVID-19 pandemic. These businesses and nonprofits have good longer-term prospects but have encountered temporary cash flow problems due to the pandemic and, as a result, are not able to get credit on reasonable terms. In addition to providing loans for borrowers in current need of funds, Main Street offers a credit backstop for firms that do not currently need funding but may if the pandemic continues to erode their financial condition.

Under Main Street, the Federal Reserve Bank of Boston has set up one SPV to manage and operate five facilities: the Main Street New Loan Facility (MSNLF), the Main Street Priority Loan Facility (MSPLF), the Main Street Expanded Loan Facility (MSELF), the Nonprofit Organization New Loan Facility (NONLF), and the Nonprofit Organization Expanded Loan Facility (NOELF). The SPV will purchase up to \$600 billion in Main Street loan participations, while lenders retain a percentage of the loans. Main Street loans have a five-year maturity, no principal payments in the first two years, and no interest payments in the first year. Businesses with less than 15,000 employees or 2019 revenues of less than \$5 billion are eligible to apply for Main Street loans. Available loan sizes span from \$100,000 to \$300 million across the facilities and depend on the size and financial health of the borrower. With funding from the CARES Act, the Department of the Treasury has committed to make a \$75 billion equity investment in the SPV.

The business facilities (MSNLF, MSPLF, and MSELF) and nonprofit facilities (NONLF and NOELF) have broadly similar terms but differ in their respective underwriting standards. The business facilities use the same eligibility criteria for lenders and borrowers and have many of the same terms, while other features of the loans extended in connection with each facility differ. The loan types also differ in how they interact with the borrower's outstanding debt, including with respect to the level of pre-crisis indebtedness a borrower may have incurred. Similarly, the nonprofit facilities have many of the same characteristics, but some features of the loans extended in connection with each facility differ. Eligible lenders may originate new loans under MSNLF, MSPLF, and NONLF or may increase the size of existing loans under MSELF and NOELF.

Main Street became operational on July 6, 2020. The Federal Reserve and the Department of the Treasury have modified the program several times to reflect extensive consultations with stakeholders, most recently by lowering the minimum loan threshold and adjusting fees to make the program more accessible. As of November 25, nearly 600 lenders representing more than half of U.S. banking assets have registered to participate in the program, and the program has purchased just under \$6 billion in participations.

Since Main Street became operational, the number of registered lenders and the amount of loan participations continue to increase. Program usage will depend on the course of the economy, the demand for credit by small and medium-sized businesses, and the ability of lenders to meet credit needs outside the Main Street program. Demand for Main Street loans may increase over

time if the pandemic continues to affect the ability of businesses and nonprofits to access credit through normal channels and as other support programs expire.

The Secondary Market Corporate Credit Facility

The Secondary Market Corporate Credit Facility (SMCCF) is designed to work alongside the Primary Market Corporate Credit Facility (PMCCF), discussed later, to support the flow of credit to large investment-grade U.S. companies so that they can maintain business operations and capacity during the period of dislocation related to COVID-19. The SMCCF supports market liquidity by purchasing, in the secondary market, corporate bonds issued by investment-grade U.S. companies, by U.S. companies that were investment grade before the onset of the pandemic and remain near investment grade, and by U.S.-listed exchange-traded funds (ETFs) whose investment objective is to provide broad exposure to the market for U.S. corporate bonds.

Under the SMCCF, the Federal Reserve Bank of New York lends to an SPV that purchases in the secondary market both corporate bond portfolios in the form of ETFs and individual corporate bonds to track a broad market index. The SMCCF purchases ETF shares and corporate bonds at fair market value in the secondary market and avoids purchasing shares of ETFs when they trade at prices that materially exceed the estimated net asset value of the underlying portfolio. The pace of purchases is a function of the condition of the U.S. corporate bond markets. With funding from the CARES Act, the Department of the Treasury has committed to make a \$75 billion equity investment in the SPV for the PMCCF and SMCCF, with a \$25 billion allocation toward the SMCCF.

The SMCCF staggered its launch of ETF and bond purchases in order to act as quickly and effectively as possible. Through ETF purchases beginning on May 12, 2020, the SMCCF provided liquidity to the corporate bond market relatively quickly. The Federal Reserve began direct corporate bond purchases under the broad market index purchase program on June 16. In its first week of bond purchases, the SMCCF was purchasing about \$370 million per day. As of November 25, purchases have been slowed to a current daily pace of approximately \$20 million of bonds and no ETFs, and the total SMCCF outstanding value has reached \$13.6 billion.

The SMCCF's announcement effect was strong, quickly improving market functioning and unlocking the supply of hundreds of billions of dollars of private credit. Since late March, more than \$1.6 trillion in corporate bonds have been issued without direct government or taxpayer involvement. The SMCCF has materially reduced its pace of purchases over the past few months as a result of the substantial improvements in the functioning of the U.S. corporate bond markets. The pace of purchases going forward will continue to be guided by measures of market functioning, increasing when conditions deteriorate and decreasing when conditions improve.

The Primary Market Corporate Credit Facility

The Primary Market Corporate Credit Facility (PMCCF) is designed to work alongside the Secondary Market Corporate Credit Facility (SMCCF) to support the flow of credit to large investment-grade U.S. companies so that they can maintain business operations and capacity during the period of dislocation related to COVID-19. The PMCCF supports market liquidity by serving as a funding backstop for corporate debt.

Under the PMCCF, the Federal Reserve Bank of New York lends to an SPV. The SPV will purchase qualifying bonds and syndicated loans with maturities up to four years. With funding from the CARES Act, the Department of the Treasury has committed to make a \$75 billion equity investment in the SPV for the PMCCF and SMCCF, with a \$50 billion allocation toward the PMCCF.

The dual announcement of the PMCCF and SMCCF was well received by the market. Between March 23 and April 6, 2020, credit spreads for investment-grade bonds declined substantially. As

of November 25, there have not been any PMCCF transactions, nor have any indications of interest been received. While the PMCCF has not purchased any bonds since it opened, it serves as a backstop should markets enter another period of stress.

The Term Asset-Backed Securities Loan Facility

The Term Asset-Backed Securities Loan Facility (TALF) supports the flow of credit to consumers and businesses by enabling the issuance of asset-backed securities (ABS) guaranteed by newly and recently originated consumer and business loans.

Under the TALF, the Federal Reserve Bank of New York lends to an SPV. The SPV will make up to \$100 billion of three-year term loans available to holders of certain triple-A-rated ABS backed by student loans, auto loans, credit card loans, loans guaranteed by the Small Business Administration (SBA), and certain other assets. The Federal Reserve lends an amount equal to the market value of the ABS less a haircut, and the loan is secured at all times by the ABS. With funding from the CARES Act, Department of the Treasury has committed to make a \$10 billion equity investment in the SPV.

As of November 25, the TALF has extended \$3.8 billion in loans since its launch on May 20, 2020. Loans have been collateralized by SBA-guaranteed ABS, commercial mortgage-backed securities (CMBS), and ABS secured by insurance premium finance loans or student loans.

The announcement and presence of the TALF has substantially helped improve liquidity in the ABS markets, including those for CMBS and collateralized loan obligations, with spreads in some ABS sectors returning close to normal levels. The TALF interest rates are attractive to borrowers when market conditions are stressed but not under normal conditions. While the facility is authorized to extend up to \$100 billion in loans, total take-up will likely be much less unless ABS market conditions worsen.