The Second Report of the Congressional Oversight Commission

June 18, 2020

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INTRODUCTION

This is the second report of the Congressional Oversight Commission (the "Commission") created by the CARES Act. The Commission's role is to conduct oversight of the implementation of Division A, Title IV, Subtitle A of the CARES Act ("Subtitle A") by the Treasury Department (the "Treasury") and the Board of Governors of the Federal Reserve System (the "Federal Reserve"). Subtitle A provided $500 billion to the Treasury for lending and other investments "to provide liquidity to eligible businesses, States, and municipalities related to losses incurred as a result of coronavirus."[1]

Of this amount, $46 billion is set aside for the Treasury itself to provide loans or loan guarantees to certain types of companies. Up to $25 billion is available for passenger air carriers, eligible businesses certified to perform inspection, repair, replace, or overhaul services, and ticket agents. Up to $4 billion is available for cargo air carriers, and up to $17 billion is available for businesses "critical to maintaining national security."[2] Any unused portions of this $46 billion, and the remaining $454 billion, may be used to support emergency lending facilities established by the Federal Reserve.

The CARES Act charges the Commission with submitting regular reports to Congress on:

- The use by the Federal Reserve of authority under Subtitle A, including with respect to the use of contracting authority and administration of the provisions of Subtitle A.
- The impact of loans, loan guarantees, and investments made under Subtitle A on the financial well-being of the people of the United States and the U.S. economy, financial markets, and financial institutions.
- The extent to which the information made available on transactions under Subtitle A has contributed to market transparency.
- The effectiveness of loans, loan guarantees, and investments made under Subtitle A in minimizing long-term costs to the taxpayers and maximizing the benefits for taxpayers.[3]

[1] CARES Act, Pub. L. No. 116-136, § 4003(a), 134 Stat. 281 (2020).
[2] *Id* at § 4003(b). In addition, Division A, Title IV, Subtitle B of the CARES Act ("Subtitle B") authorized the Treasury to provide up to $32 billion in financial assistance to passenger air carriers, cargo air carriers, and certain airline industry contractors that must be exclusively used for the continuation of payment of employee wages, salaries, and benefits. Of this amount, up to $25 billion is available for passenger air carriers; up to $4 billion is available for cargo air carriers; and up to $3 billion is available for certain airline industry contractors. The Treasury has begun to provide some of this financial assistance. Subtitle B is not within the jurisdiction of the Congressional Oversight Commission (the "Commission").
[3] CARES Act, Pub. L. No. 116-136, § 4020, 134 Stat. 281 (2020).

In its first report to Congress on May 18, 2020, the Commission stated that it is responsible for answering two basic questions:

- What are the Treasury and the Federal Reserve doing with $500 billion of taxpayer money?

- Who is that money helping?[4]

That first report posed some preliminary questions the Commission had about the initial actions of the Treasury and the Federal Reserve in implementing Subtitle A. On May 29, the Commission sent a letter to Treasury Secretary Steven Mnuchin and the Federal Reserve Chair Jerome Powell asking them to provide answers to those questions.[5] The letter divided the questions into two tiers. The Commission requested that the Treasury and the Federal Reserve provide answers to the tier 1 questions by June 8, and answers to the tier 2 questions by June 29. On June 8, the Treasury and the Federal Reserve sent a response letter to the Commission that provided answers to the tier 1 questions. [6]

The Commission's letter of May 29 also requested a meeting between the Commission and Secretary Mnuchin and Chair Powell. That meeting is scheduled to take place later in June.

In this report, we describe recent key actions the Treasury and the Federal Reserve have taken under Subtitle A and list and discuss the answers they have provided to the Commission's tier 1 questions from our first report.

[4] Congressional Oversight Commission, Questions About the CARES Act's $500 Billion Emergency Economic Stabilization Funds, at 5, May 18, 2020, https://www.toomey.senate.gov/files/documents/COC%201st%20Report_05.18.2020.pdf.
[5] Appendix A of this report contains a copy of the Commission's letter of May 29, 2020.
[6] Appendix B of this report contains a copy of the Treasury and the Federal Reserve's letter of June 8, 2020.

EXECUTIVE SUMMARY

In the eleven-plus weeks since the CARES Act became law, the Treasury and the Federal Reserve have announced how they plan to use $195 billion of the $454 billion specifically allocated by that law to support emergency lending facilities established by the Federal Reserve. That money has been dedicated to several lending facilities that the Federal Reserve states could support nearly $2 trillion in loans and asset purchases. To date, the majority of those lending facilities are not operational, and the facilities have made a total of $6.7 billion in purchases.

One of the responsibilities of the Commission is to issue reports evaluating the effect of Federal Reserve and Treasury actions on the financial well-being of the people of the United States. The effect of these actions on the financial well-being of the American people is difficult to fully quantify, though it is clear that some parts of the economy are in much better shape and some entities have benefited more than others. In some areas of the economy, such as the ability of larger companies to issue debt to continue operations, the agencies' actions have had a clear and powerful impact.[7] But there is less evidence that the actions of the Treasury and the Federal Reserve have been as beneficial for small and mid-sized businesses and state and local governments.

The Federal Reserve's mere announcement that it was establishing these facilities has helped improve the condition and performance of financial markets. This improvement has enabled certain larger businesses to access credit through the capital markets at lower rates to fund their operations during these challenging times. In addition, many direct and indirect owners of financial assets, such as investors, retirees, and pension recipients, have seen those assets recover or gain value due to the improvement of the financial markets.

The Commission cannot conclude whether the improved condition and performance of financial markets has also indirectly improved access to credit for small and mid-sized companies that do not have access to the debt market. But the agencies' facility that is intended to directly support credit to these companies—the Main Street Lending program—is not yet operational. The facility is expected to launch soon, which should provide the Commission with more insight into the condition of small and mid-sized companies.

The lending facility established to provide funding to state and local governments has extended assistance to only one state. The facility started to operate very recently, and as such, that number may increase. Falling yields have enabled some state and local governments to access credit through the issuance of municipal bonds in the capital markets, but it is unclear at this juncture to what extent, if at all, the agencies' municipal liquidity facility has lowered the cost of borrowing in private markets. The Commission will continue to closely monitor this facility.

[7] In certain respects, it is an open question as to whether the Federal Reserve should even continue its secondary market corporate bond-buying activities.

At this time, the facilities that the Federal Reserve and the Treasury have stated will receive CARES Act funds are:

- The Primary Market Corporate Credit Facility (PMCCF) and Secondary Market Corporate Credit Facility (SMCCF): The Treasury has announced it intends to make a total equity investment of $75 billion in these facilities. The SMCCF buys previously issued corporate bonds and exchange-traded funds (ETFs) that invest in corporate bonds. The PMCCF will purchase newly issued corporate bonds and portions of syndicated loans. Collectively, these facilities can support up to $750 billion in purchases.[8] As of June 10, the Treasury has invested $37.5 billion in the special purpose vehicle (SPV) it uses for the PMCCF and SMCCF.[9]

- The Main Street Lending Program: The Treasury has announced it intends to make an equity investment of $75 billion in this program, which will back loans to small and medium-sized businesses with up to 15,000 employees. The Federal Reserve may also expand this program to include certain nonprofit organizations. The Main Street Lending Program can support up to $600 billion in lending.[10] As of June 10, the Treasury has invested $37.5 billion in this program.[11]

- The Municipal Liquidity Facility (MLF): The Treasury has announced it intends to make an equity investment of $35 billion in this facility, which purchases short-term notes issued by state and local governments. The MLF can provide up to $500 billion in

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[8] Board of Governors of the Federal Reserve System, *Primary Corporate Credit Facility Term Sheet,* Apr. 9, 2020, https://www.federalreserve.gov/newsevents/pressreleases/files/monetary20200409a5.pdf.

[9] Board of Governors of the Federal Reserve System, Statistical Release H.4.1, *Factors Affecting Reserve Balances of the Depository Institutions and Condition Statement of Federal Reserve Banks*, June 11, 2020, https://www.federalreserve.gov/releases/h41/ (to access click on hyperlink for June 11, 2020 release). The SPV for the PMCCF and SMCCF is Corporate Credit Facilities LLC.

[10] Board of Governors of the Federal Reserve System, *Main Street New Loan Facility Term Sheet,* June 8, 2020, https://www.federalreserve.gov/newsevents/pressreleases/files/monetary20200608a1.pdf.

[11] Board of Governors of the Federal Reserve System, Statistical Release H.4.1, *Factors Affecting Reserve Balances of the Depository Institutions and Condition Statement of Federal Reserve Banks*, June 11, 2020, https://www.federalreserve.gov/releases/h41/ (to access click on hyperlink for June 11, 2020 release). The SPV for the Main Street Lending Program is MS Facilities LLC (MSFL). The H.4.1 statistical release dated June 11, 2020 indicates the MSFL did not hold any "loan participations" (i.e., loans) as of June 10, 2020. However, the release indicates that the MSFL's net portfolio holdings, as of June 10, 2020, were $31.875 billion. These holdings do not consist of loans, but rather consist of nonmarketable Treasury securities. The MSFL is required to invest 85% of the Treasury's equity investment in the facility in such securities. The Treasury's current equity investment is $37.5 billion and 85% of that investment equals $31.875 billion.

lending.[12] As of June 10, the Treasury has invested $17.5 billion in the MLF.[13]

- The Term Asset-Backed Securities Loan Facility (TALF): The Treasury has announced it intends to make an equity investment of $10 billion in this facility, which will make loans to companies secured by consumer or business loans. The TALF can provide up to $100 billion in lending.[14] As of June 10, the Treasury had not invested any funds in this facility.[15]

The Federal Reserve has stated that these facilities could support up to $1.95 trillion in purchases and loans if necessary. However, to date, only two of these facilities—the SMCCF and the MLF—are operational and have collectively made $6.7 billion in purchases and loans:

- The SMCCF has purchased $5.5 billion worth of corporate bond ETFs as of June 10.[16]

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[12] Board of Governors of the Federal Reserve System, *Municipal Liquidity Facility Term Sheet,* June 3, 2020, https://www.federalreserve.gov/newsevents/pressreleases/files/monetary20200603a1.pdf; Federal Reserve Bank of New York, *FAQs: Municipal Liquidity Facility,* June 3, 2020, https://www.newyorkfed.org/markets/municipal-liquidity-facility/municipal-liquidity-facility-faq.
[13] Board of Governors of the Federal Reserve System, Statistical Release H.4.1, *Factors Affecting Reserve Balances of the Depository Institutions and Condition Statement of Federal Reserve Banks*, June 11, 2020, https://www.federalreserve.gov/releases/h41/ (to access click on hyperlink for June 11, 2020 release). The SPV for the Municipal Liquidity Facility is the Municipal Liquidity Facility LLC (MLFL). The H.4.1 statistical release dated June 11, 2020 indicates the MFLF held $1.2 billion of municipal notes as of June 10, 2020. However, the release indicates that the MFLF's net portfolio holdings, as of June 10, 2020, were $16.07 billion. These holdings consist of MFL's $1.2 billion of loans and $14.875 billion of nonmarketable Treasury securities. The MFLF is required to invest 85% of the Treasury's equity investment in the facility in such securities. The Treasury's current equity investment is $17.5 billion and 85% of that investment equals $14.875 billion.
[14] Board of Governors of the Federal Reserve, *Term Asset-Backed Securities Loan Facility,* May 12, 2020, https://www.federalreserve.gov/newsevents/pressreleases/files/monetary20200512a1.pdf.
[15] Board of Governors of the Federal Reserve System, Statistical Release H.4.1, *Factors Affecting Reserve Balances of the Depository Institutions and Condition Statement of Federal Reserve Banks*, June 11, 2020, https://www.federalreserve.gov/releases/h41/ (to access click on hyperlink for June 11, 2020 release). The H.4.1 statistical release dated June 11, 2020 does not indicate any Treasury investment in an SPV for TALF.
[16] This calculation was determined using the Federal Reserve's statistical release H.4.1, "Factors Affecting Reserve Balances of the Depository Institutions and Condition Statement of Federal Reserve Banks," which presents the balance sheet of the Federal Reserve on a weekly basis. Past H.4.1 statistical releases are available on the Federal Reserve's website at https://www.federalreserve.gov/releases/h41/. Corporate Credit Facilities LLC (CCFL) is the SPV for the SMCCF and PMCCF. The H.4.1 statistical release dated May 28, 2020 states that 85% of the Treasury's equity investment in the CCFL is invested in nonmarketable Treasury securities and reported in the net portfolio holdings of the CCFL. The Treasury's equity investment in the CCFL was $37.5 billion as of June 10, 2020. 85% of $37.5 billion is $31.875 billion. According to the H.4.1 statistical release dated June 11, 2020 the net portfolio holdings of the CCFL were $37.374 billion as of June 10, 2020. When $31.875 billion is subtracted from $37.374 billion the result is $5.5 billion. This represents the amount of value of the bond ETFs that the SMCCF has purchased as of June 10, 2020, since the PMCCF has not made any purchases to date.

- The MLF has made a single purchase of $1.2 billion in notes from the State of Illinois.[17]

The Treasury and the Federal Reserve have also announced that the Main Street Lending Program is accepting lender registration applications and will begin to purchase loans soon. The remaining two programs—the PMCCF and the TALF—are not yet operational.

The Treasury has received applications for loans under Subtitle A from the airline industry and businesses critical to maintaining national security. At least, one airline—American Airlines—has announced that it expects to receive a $4.75 billion loan in June. However, to date, the Treasury has not yet made any loans using the $29 billion allocated for loans to the airline industry and the $17 billion allocated for loans to national security businesses.

The announcement of these plans has had a significant effect on the functioning of credit markets and the ability of businesses to access capital. In February and March, the corporate bond market saw a widening gap between bid and ask prices for bonds.[18] Meanwhile, the spread between investment grade debt and Treasurys had increased significantly.[19] In March, the yields and spreads for municipal debt jumped, "with spreads to comparable-maturity Treasury securities spiking to their highest level since the [2008] Global Financial Crisis."[20] However, since the Federal Reserve's March 23 announcement about the creation of the PMCCF and SMCCF, the gap between bid and ask prices has narrowed sharply, improving liquidity for both the investment grade and non-investment grade bond markets.[21] And, the spread between investment grade debt and Treasurys has dropped almost in half.[22] Yields on municipal bond debt have also improved since late March.[23]

As the cost of borrowing has dropped, U.S. corporate bond issuance has risen. In April and May, U.S. corporate bond issuance, including investment grade and high-yield bonds, totaled over $300 billion each month, far outpacing the $105 billion and $130 billion in issuances in April

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[17] Shruti Singh & Amanda Albright, *Illinois Becomes First to Tap Fed Loans After Yields Surge,* Bloomberg, June 2, 2020, https://www.bloomberg.com/news/articles/2020-06-02/illinois-becomes-first-to-tap-fed-loans-after-bond-yields-surge; Board of Governors of the Federal Reserve System, Statistical Release H.4.1, *Factors Affecting Reserve Balances of the Depository Institutions and Condition Statement of Federal Reserve Banks*, June 11, 2020, https://www.federalreserve.gov/releases/h41/ (to access click on hyperlink for June 11, 2020 release). The H.4.1 statistical release dated June 11, 2020 indicates the MFLF held $1.2 billion of municipal notes as of June 10, 2020.

[18] Samuel Agini & Eric Platt, *Investors adapt to 'new normal' on corporate bond trading,* Financial Times, Apr. 21, 2020, https://www.ft.com/content/f0f9bf4d-9318-4f17-82bc-c1cd600412a9.

[19] Patti Domm, *Corporations raise $1 trillion in the bond market amid Fed backstop, double the pace of last year,* CNBC, May 29, 2020, https://www.cnbc.com/2020/05/29/corporations-raise-1-trillion-in-the-bond-market-after-fed-backstop-double-the-pace-of-last-year.html.

[20] Board of Governors of the Federal Reserve System, Monetary Policy Report, at 28, June 12, 2020, https://www.federalreserve.gov/monetarypolicy/files/20200612_mprfullreport.pdf.

[21] Mahyar Kargar et al., *Corporate Bond Liquidity During the COVID-19 Crisis*, National Bureau of Economic Research, June 2020, https://www.nber.org/papers/w27355.pdf.

[22]Patti Domm, *Corporations raise $1 trillion in the bond market amid Fed backstop, double the pace of last year,* CNBC, May 29, 2020, https://www.cnbc.com/2020/05/29/corporations-raise-1-trillion-in-the-bond-market-after-fed-backstop-double-the-pace-of-last-year.html.

[23] Board of Governors of the Federal Reserve System, *Monetary Policy Report*, at 28, June 12, 2020, https://www.federalreserve.gov/monetarypolicy/files/20200612_mprfullreport.pdf.

2019 and May 2019, respectively.[24] State and local governments seeking financing through the capital markets also increased during that time. In April 2020 and May 2020, total U.S. municipal bond issuances also rose to $29.4 billion and $29.2 billion, respectively, after having fallen to $18.7 billion in March.[25]

Firms have taken advantage of the lower borrowing costs to make noteworthy changes to operations. According to recent reporting, some companies that have issued debt during the Spring are doing so to raise money to withstand further possible disruptions caused by COVID-19. Some have proceeded to restructure and lay off workers while continuing to issue dividends to shareholders while other corporations issuing debt have announced that they will hire additional workers.[26]

The improved performance and condition of financial markets extend beyond debt and into equity. Beginning on February 19, the S&P 500 Index began a swift and sharp decline. From February 19 to March 23, the S&P 500 Index fell 30%, which was the fastest 30% drop in the U.S. stock market's history.[27] Since then, the S&P 500 Index has substantially recovered. Between March 23, when the Federal Reserve first announced its plans to establish the Main Street Lending Program, the SMCCF, the PMCCF, and the TALF, and June 8, the S&P 500 Index fully erased this 30% decline.[28] On June 9, the Nasdaq Composite, which is an index dominated by technology company stocks, hit an all-time high when it closed above 10,000 for the first time.[29]

Financial markets still face significant uncertainty. For instance, on June 11, the U.S. stock market experienced its worst single day decline since March when the Dow Jones Industrial Average dropped 6.9% and the S&P 500 Index fell 5.9%.[30] The same day the Cboe Volatility

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[24] Securities Industry and Financial Markets Association, *U.S. Corporate Bond Issuance,* Jun. 1, 2020, https://www.sifma.org/wp-content/uploads/2017/08/Corporate-US-Corporate-Issuance-SIFMA.xls.

[25] Securities Industry and Financial Markets Association, *US Municipal Issuance*, June 1, 2020, https://www.sifma.org/resources/research/us-municipal-issuance/.

[26] Bob Ivry et al., *Fed Vow Boosts Debt Binge as Borrowers Cut Thousands of Jobs*, Bloomberg, June 5, 2020, at https://www.bloomberg.com/news/articles/2020-06-05/fed-vow-boosts-debt-binge-while-borrowers-cut-thousands-of-jobs.

[27] Yun Li, *This was the fastest 30% sell-off ever, exceeding the pace of declines during the Great Depression,* CNBC, Mar. 23, 2020, https://www.cnbc.com/2020/03/23/this-was-the-fastest-30percent-stock-market-decline-ever.html.

[28] Michael Wusthorn & Anna Isaac, *S&P 500 Rebounds to Close in Positive Territory for the Year,* Wall Street Journal, June 8, 2020, https://www.wsj.com/articles/global-stock-markets-dow-update-06-08-2020-11591592116.

[29] Fred Imbert & Maggie Fitzgerald, *Dow and S&P 500 post back-to-back losses, but Nasdaq closes above 10,000 for the first time,* CNBC, June 9, 2020, https://www.cnbc.com/2020/06/09/stock-market-futures-open-to-close-news.html; *Nasdaq Composite Closes Above 10,000 for the First Time,* Nasdaq, June 10, 2020, https://www.nasdaq.com/articles/nasdaq-composite-closes-above-10000-for-the-first-time-2020-06-10.

[30] Matt Phillips, *Investors, No Longer in Denial About Grim Outlook, Drive Market Down,* New York Times, June 11, 2020, https://www.nytimes.com/2020/06/11/business/market-drop-coronavirus.html.

Index (the VIX Index), "known as Wall Street's 'fear gauge'," closed at its highest level since April 23.[31]

Other U.S. economic indicators remain troubling, though there have been some positive developments. According to the National Bureau of Economic Research, the U.S. economy officially entered an economic recession in February 2020, marking the end of an historic 128-month business expansion that began in June 2009.[32] The Federal Reserve's most recent economic projections predict that the U.S. economy, as measured by gross domestic product (GDP), will decline 6.5% in 2020, but then grow by 5% in 2021.[33] In May, retail sales increased 17.7% from April, which was the largest increase on record since 1992.[34] Yet, retail sales were down 6.1% from the same month a year earlier.[35]

The U.S. unemployment rate remains historically high. In April, it reached a post-World War II high of 14.7%.[36] The following month, the unemployment rate declined to 13.3% as nonfarm payroll employment increased by 2.5 million jobs in May.[37] However, the U.S. Bureau of Labor Statistics (BLS) recently discovered that the unemployment rates for March, April, and May 2020 were likely higher than reported due to an error in the way the workers were classified by the government. Some workers who were employed, but who were absent from work due to COVID-19, were classified as employed when they should have been classified as "unemployed on temporary layoff."[38] According to BLS, if these workers were classified as unemployed on temporary layoff, "the overall unemployment rate would have been 3 percentage points higher than reported." Even accounting for this issue, which existed in the April employment report as well, the unemployment rate is believed to have declined significantly from April to May.[39]

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[31] April Joyner, *Wall Street's 'Fear Gauge' Jumps on Fears of Coronavirus Resurgence,* Reuters, June 11, 2020, https://www.reuters.com/article/us-health-coronavirus-vix/wall-streets-fear-gauge-jumps-on-fears-of-coronavirus-resurgence-idUSKBN23I3BJ.

[32] National Bureau of Economic Research, *Determination of the February 2020 Peak in the US Economic Activity,* June 8, 2020, https://www.nber.org/cycles/june2020.html.

[33] Board of Governors of the Federal Reserve System and the Federal Open Market Committee, *Economic Projections of the Federal Reserve Board Members and Federal Reserve Bank Presidents, Under Their Individual Assumptions of Projected Appropriate Monetary Policy, June 2020,* June 10, 2020, https://www.federalreserve.gov/monetarypolicy/files/fomcprojtabl20200610.pdf; Jeff Cox, *Fed Sees Interest Rates Staying Near Zero Through 2022, GDP Bouncing to 5% Next Year,* June 10, 2020, https://www.cnbc.com/2020/06/10/fed-meeting-decision-interest-rates.html.

[34] Harriet Torry & Sarah Nassauer, *U.S. Retail Sales Rose Record 18% in May*, Wall Street Journal, June 16, 2020, https://www.wsj.com/articles/shoppers-returned-in-may-likely-spurring-increased-retail-sales-11592299802.

[35] *Id*.

[36] Josh Mitchell, *U.S. Unemployment Rate Fell to 13.3% in May,* Wall Street Journal, June 6, 2020, https://www.wsj.com/articles/may-jobs-report-coronavirus-2020-11591310177.

[37] *Id*.

[38] U.S. Bureau of Labor Statistics, *The Employment Situation—May 2020*, at 6, June 5, 2020, https://www.bls.gov/news.release/pdf/empsit.pdf.

[39] Heather Long, *A 'misclassification error' made the May unemployment rate look better than it is. Here's what happened*, June 6, 2020, https://www.washingtonpost.com/business/2020/06/05/may-2020-jobs-report-misclassification-error/; U.S. Bureau of Labor Statistics, *The Employment Situation—April 2020*, at 5, May 8, 2020, https://www.bls.gov/news.release/archives/empsit_05082020.pdf (noting that the unemployment rate for April 2020 would have been almost 5 percentage points higher than the reported figure of 14.7% if not for the misclassification); U.S. Bureau of Labor Statistics, *The Employment Situation—May 2020*, at 6, June 5, 2020,

May's employment report showed that the unemployment rate fell for many groups within the workforce. Unemployment among women declined by 1.6%.[40] Veterans experienced a 2.7% drop in unemployment.[41] Individuals with less than a high school diploma saw a 1.3% decrease in unemployment, while high school graduates with no college degree saw a 2% decline.[42] The unemployment rate for disabled individuals fell by 1.0%.[43] Unemployment among workers in the manufacturing sector declined by 1.6%,[44] which was coupled with a 0.3% increase in overtime hours in that sector.[45] But May's employment report also reflected the continued outsized impact of COVID-19 on Black and Hispanic people. The Black unemployment rate increased by 0.1% and Hispanics had the highest rate of unemployment of any race—though their unemployment rate did decline by 1.3% in May.[46]

Separately, the report showed that the number of people whose employment ended involuntarily increased by 14.75%.[47] The number of permanent job losses increased by roughly 250,000.[48] Looking forward, the Federal Reserve projects the unemployment rate will be 9.3% at the end of 2020 and 6.5% at the end of 2021—significantly higher than its projections before the COVID-19 crisis.[49]

With regard to employment, the Federal Reserve noted in its answers to the Commission's questions that it "designed the [emergency lending] facilities to work together to protect financial stability and support achievement of its dual mandate of full employment and price stability."[50] There are multiple ways the Federal Reserve could use the facilities to try to promote full employment in the U.S. economy. One way is to make sure that credit is flowing to businesses so that they can fund their operations and continue to employ workers as they see fit. The Federal Reserve has pursued this path through multiple actions, including the establishment of emergency lending facilities using CARES Act funds. Based on the information we have to date,

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https://www.bls.gov/news.release/pdf/empsit.pdf (noting that the unemployment rate for May 2020 would have been about 3 percentage points higher than the reported figure of 13.3% if not for the misclassification).

[40] U.S. Bureau of Labor Statistics, *The Employment Situation—May 2020*, at Summary table A, June 5, 2020, https://www.bls.gov/news.release/pdf/empsit.pdf.

[41] U.S. Bureau of Labor Statistics, *The Employment Situation—April 2020*, at Table A-5, May 8, 2020, https://www.bls.gov/news.release/archives/empsit_05082020.htm; U.S. Bureau of Labor Statistics, *The Employment Situation—May 2020*, at Table A-5, June 5, 2020, https://www.bls.gov/news.release/pdf/empsit.pdf.

[42] *Id*. at Table A-4.

[43] *Id*. at Table A-6.

[44] *Id*. at Table A-14.

[45] U.S. Bureau of Labor Statistics, *The Employment Situation—May 2020*, at Table B-2, June 5, 2020, https://www.bls.gov/news.release/pdf/empsit.pdf.

[46] *Id*. at Summary table A.

[47] *Id*. at Table A-11.

[48] *Id*.

[49] Board of Governors of the Federal Reserve System and the Federal Open Market Committee, *Economic Projections of the Federal Reserve Board Members and Federal Reserve Bank Presidents, Under Their Individual Assumptions of Projected Appropriate Monetary Policy, June 2020,* June 10, 2020, https://www.federalreserve.gov/monetarypolicy/files/fomcprojtabl20200610.pdf.

[50] Letter from Treasury Secretary Steven Mnuchin and Federal Reserve Chair Jerome Powell to Congressional Oversight Commission, at 1, June 8, 2020 (letter available in Appendix B to this report).

the Federal Reserve's actions, such as the establishment of the SMCCF and PMCCF, have helped larger businesses obtain credit more cheaply through the capital markets.

Another way the Federal Reserve could try to promote employment is to require businesses to maintain their payrolls or attempt to rehire workers when they obtain credit through the Federal Reserve's lending facilities.[51]

The PMCCF, SMCCF, and MLF do not impose any payroll conditions on borrowers, but the Main Street Lending Program does require businesses to make "commercially reasonable efforts" to maintain payroll.[52] The Federal Reserve has defined such "commercially reasonable efforts" to mean that a business should make "good-faith efforts to maintain payroll and retain employees in light of their respective capacities, economic environment, available resources, and business need for labor."[53] In their answers to the Commission's questions, the agencies stated that "[s]uch efforts may take different forms across the broad range of businesses eligible for the program." [54] The agencies also stated that "[b]ecause of the variety of approaches [they] expect from borrowers, the agencies will monitor the program's impact on the economic recovery and employment broadly rather than on a borrower-by-borrower basis." [55] This answer suggests that the agencies will not monitor whether individual businesses that receive Main Street loans are making "commercially reasonable efforts" to maintain payroll.

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[51] While the Federal Reserve can choose to impose payroll conditions on borrowers from its lending facilities, Congress in the CARES Act did not require the Federal Reserve to do so. In contrast, Congress did choose to impose payroll conditions on borrowers that receive certain other forms of financial assistance under the CARES Act, such as the Small Business Administration's Paycheck Protection Program loans and the Treasury's grants to the airline industry under Division A, Title IV, Subtitle B.

[52] *See, e.g.*, Board of Governors of the Federal Reserve System, *Main Street New Loan Facility Term Sheet*, June 8, 2020, https://www.federalreserve.gov/newsevents/pressreleases/files/monetary20200608a1.pdf.

[53] Federal Reserve Bank of Boston, *Main Street Lending Program Frequently Asked Questions*, June 8, 2020, https://www.bostonfed.org/-/media/Documents/special-lending-facilities/mslp/legal/frequently-asked-questions-faqs.pdf (defining "commercially reasonable efforts" as "good-faith efforts to maintain payroll and retain employees, in light of its capacities, the economic environment, its available resources, and the business need for labor.").

[54] Letter from Treasury Secretary Steven Mnuchin and Chair Board of Governors of the Federal Reserve System to Congressional Oversight Commission, at 10, June 8, 2020 (letter available in Appendix B to this report).

[55] *Id*.

TREASURY AND FEDERAL RESERVE RECENT DEVELOPMENTS

In May and June, the Treasury and the Federal Reserve took a number of actions under Division A, Title IV, Subtitle A of the CARES Act. The key recent developments are described below.

Primary Market Corporate Credit Facility (PMCCF)

The PMCCF is intended to support credit to businesses by serving as a "funding backstop" for corporate debt.[56] The Federal Reserve, through a special purpose vehicle (SPV), will be the sole purchaser of newly issued corporate bonds or purchase portions of bonds or syndicated loans, at issuance, from corporations rated investment grade as of March 22, 2020.[57] The Treasury intends to make a total equity investment of $75 billion in the PMCCF and the SMCCF, which can support up to $750 billion in purchases through both facilities.[58] As of June 10, the Treasury has invested $37.5 billion in the SPV it uses for the PMCCF and SMCCF. On May 19, Chair Powell testified before Congress that he expected the PMCCF to be operational by the end of May or the beginning of June.[59] As of June 17, the PMCCF was not yet operational and, therefore, had not made any purchases.

Secondary Market Corporate Credit Facility (SMCCF)

The SMCCF is intended to support credit to businesses by providing liquidity to the market for outstanding corporate bonds. The Federal Reserve, through an SPV, purchases individual corporate bonds issued by corporations rated investment grade as of March 22, 2020 on the secondary market, as well as U.S.-listed exchange-traded funds (ETFs) that themselves invest in a broad range of corporate bonds. As mentioned, the Treasury intends to invest a total of $75 billion in the PMCCF and the SMCCF, which can support up to $750 billion in purchases. As of June 10, the Treasury has invested $37.5 billion in the SPV it uses for the PMCCF and SMCCF.

On May 12, the SMCCF began to make purchases of ETFs.[60] The Federal Reserve submitted a periodic report about the SMCCF to the Senate Banking Committee and the House Financial Services Committee on May 28 that disclosed information about the facility's initial ETF purchases.[61] As of May 19, the SMCFF had purchased over 17 million shares in fifteen ETFs.

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[56] Board of Governors of the Federal Reserve System, *Primary Market Corporate Credit Facility Term Sheet*, Apr. 9, 2020, https://www.federalreserve.gov/newsevents/pressreleases/files/monetary20200409a5.pdf.
[57] *Id*.
[58] *Id*.
[59] Senate Banking, Housing, and Urban Affairs Committee hearing on the Quarterly CARES Act Report to Congress, 116th Cong. (May 19, 2020) (statement of Jerome Powell, Chair, the Board of Governors of the Federal Reserve).
[60] Federal Reserve Bank of New York, *New York Fed Announces Start of Certain Secondary Market Purchases on May 12,* May 11, 2020, https://www.newyorkfed.org/newsevents/news/markets/2020/20200511.
[61] Board of Governors of the Federal Reserve System, *Periodic Report: Update on Outstanding Lending Facilities Authorized by the Board under Section 13(3) of the Federal Reserve Act,* May 28, 2020, https://www.federalreserve.gov/files/pmccf-smccf-talf-5-29-20.pdf#page=2.

The total market value of these shares was $1.3 billion as of May 19.[62] The SMCCF engaged in 158 trades with ten different sellers to make these purchases.[63]

The chart below lists the names of the ETFs that the SMCCF has purchased, the number of shares purchased, and the market value of those shares as of May 19.[64]

Name of ETF	Shares Purchased	Market Value as of 5/19/20 (U.S. $)
iShares iBoxx US Dollar Investment Grade Corporate Bond ETF	2,521,892	$326,282,386.96
iShares iBoxx High Yield Corporate Bond ETF	1,255,084	$100,657,736.80
SPDR Bloomberg Barclays High Yield Bond ETF	905,284	$89,532,587.60
iShares Short-Term Corporate Bond ETF	1,639,301	$88,341,930.89
SPDR Portfolio Intermediate Term Corporate Bond ETF	1,942,325	$69,030,230.50
iShares Intermediate-Term Corporate Bond ETF	997,134	$57,973,370.76
SPDR Portfolio Short Term Corporate Bond ETF	1,339,345	$41,613,449.15
VanEck Vectors Fallen Angel High Yield Bond ETF	410,585	$11,106,324.25
Xtrackers US Dollar High Yield Corporate Bond ETF	240,996	$11,006,287.32
iShares 0-5 Year Investment Grade Corporate Bond ETF	198,064	$10,208,218.56
iShares 0-5 Year High Yield Corporate Bond ETF	171,837	$7,175,913.12
iShares Broad US Dollar High Yield Corporate Bond ETF	104,979	$3,884,223.00
iShares Broad US Dollar Investment Grade Corporate Bond ETF	616,593	$35,922,708.18
Vanguard Intermediate-Term Corporate Bond ETF	2,483,885	$228,095,159.55
Vanguard Short-Term Corporate Bond ETF	2,776,786	$226,196,987.56

The Federal Reserve also provides weekly disclosures of the amount of purchases it has made through the SPV for the SMCCF and PMCCF. Based on the most recent disclosure, we calculate that SPV has made $5.5 billion in corporate bond ETF purchases through the SMCCF as of June 10.[65]

On June 15, the Federal Reserve announced that the SMCCF will begin purchasing individual corporate bonds beginning on June 16.[66] The SMCCF will initially purchase individual "corporate bonds to create a corporate bond portfolio that is based on a broad, diversified index

[62] Board of Governors of the Federal Reserve System, *SMCCF Transaction Specific Disclosures,* May 28, 2020, https://www.federalreserve.gov/files/smccf-transition-specific-disclosures-5-29-20.xlsx.
[63] *Id*.; These broker-dealers are: Barclays Capital Inc., BMO Capital Markets Corp., BNP Paribas Securities Corp., BOFA Securities, INC., Citigroup Global Markets Inc., Goldman Sachs & Co. LLC, Jefferies LLC, Morgan Stanley & Co. LLC, UBS Securities LLC, and Wells Fargo Securities, LLC.
[64] Board of Governors of the Federal Reserve System, *CCF – Monthly Report*, May 19, 2020, https://www.federalreserve.gov/publications/files/smccf-transition-specific-disclosures-5-29-20.xlsx.
[65] *See* note 16.
[66] Board of Governors of the Federal Reserve System, *Federal Reserve Board announces updates to Secondary Market Corporate Credit Facility (SMCCF), which will begin buying a broad and diversified portfolio of corporate bonds to support market liquidity and the availability of credit for large employers*, June 15, 2020, https://www.federalreserve.gov/newsevents/pressreleases/monetary20200615a.htm.

of U.S. corporate bonds."[67] According to the announcement, this index will consist of all the U.S. corporate bonds in the secondary market that satisfy the SMCCF's eligibility criteria, such as minimum credit ratings and maximum maturity. However, an issuer is not required to certify its compliance with the SMCCF's eligibility criteria before the SMCCF buys its individual bonds as part of this indexing approach.[68] This is a change from the Federal Reserve's previous May 26 guidance that stated an issuer would be required to provide such a certification before the SMCCF purchased its individual bonds.[69]

The Federal Reserve stated that its "indexing approach will complement the [SMCCF's] current purchases of [ETFs]."[70] It also stated that, in the future, the SMCCF may purchase individual corporate bonds using other methodologies.[71] Although the Federal Reserve announced in March and April that the SMCCF would purchase individual corporate bonds, June 15 was the first time it revealed this indexing approach to buy individual bonds.

Main Street Lending Program

The Main Street Lending Program is intended to facilitate lending by banks to small and medium-sized businesses. Businesses with up to 15,000 employees or up to $5 billion in 2019 annual revenues are eligible to receive loans under this program. The Main Street Lending Program currently consists of three facilities: the Main Street New Lending Facility (MSNLF), the Main Street Priority Loan Facility (MSPLF), and the Main Street Expanded Loan Facility (MSELF) (collectively, the "Main Street facilities"). However, the Federal Reserve recently announced that it may expand the Main Street facilities to include two facilities to provide loans to certain nonprofit organizations. The Treasury has announced it intends to make an equity investment of $75 billion in the Main Street facilities. Collectively, they can support up to $600 billion in lending.[72]

On May 19, Chair Powell testified before Congress that he expected the Main Street facilities to be operational by the end of May or the beginning of June.[73] To facilitate putting these facilities

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[67] *Id*.
[68] Federal Reserve Bank of New York, *FAQs: Primary Market Corporate Credit Facility and Secondary Market Corporate Credit Facility*, June 15, 2020, https://www.newyorkfed.org/markets/primary-and-secondary-market-faq/corporate-credit-facility-faq.
[69] Federal Reserve Bank of New York, *FAQs: Primary Market Corporate Credit Facility and Secondary Market Corporate Credit Facility*, May 26, 2020, https://www.newyorkfed.org/markets/primary-and-secondary-market-faq/archive/corporate-credit-facility-faq-200526.
[70] Board of Governors of the Federal Reserve System, *Federal Reserve Board announces updates to Secondary Market Corporate Credit Facility (SMCCF), which will begin buying a broad and diversified portfolio of corporate bonds to support market liquidity and the availability of credit for large employers*, June 15, 2020, https://www.federalreserve.gov/newsevents/pressreleases/monetary20200615a.htm.
[71] *Id*.
[72] Board of Governors of the Federal Reserve System, *Main Street New Loan Facility Term Sheet,* June 8, 2020, https://www.federalreserve.gov/newsevents/pressreleases/files/monetary20200608a1.pdf.
[73] Senate Banking, Housing, and Urban Affairs Committee hearing on the Quarterly CARES Act Report to Congress, 116th Cong. (May 19, 2020) (statement of Jerome Powell, Chair, the Board of Governors of the Federal Reserve).

into operation, on May 27, the Federal Reserve Bank of Boston released registration documents to enable lenders to participate in the facilities and form loan documentation and agreements, such as a loan participation agreement and borrower and lender certifications and covenants.[74]

On June 8, the Federal Reserve announced changes to the Main Street facilities "to allow more small and medium-sized businesses to be able to receive support."[75] These changes included:

- Lowering the minimum loan size from $500,000 to $250,000 for the MSNLF and MSPLF.
- Raising the maximum loan size for all the facilities.
- Increasing the loan term from four years to five years for all the facilities.
- Extending the deferral of principal payments from one year to two years for all the facilities.
- Increasing the Federal Reserve's stake in MSPLF loans from 85% to 95%, so that the Federal Reserve's stake in loans in all of the facilities is now 95%.

The Federal Reserve's announcement on June 8 stated that once lenders "have successfully registered for the [Main Street Lending Program], lenders are encouraged to begin making Main Street loans immediately."[76] On June 15, the Federal Reserve Bank of Boston began accepting lender registration applications and announced that the facilities will begin buying loans soon.[77] As of June 17, 2020, the Main Street facilities were not yet operational.

The chart below shows the current key terms and conditions of the Main Street facilities, as amended by the Federal Reserve's June 8 announcement.

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[74] Federal Reserve Bank of Boston, *Main Street Lending Program Frequently Asked Questions,* June 8, 2020, available at: https://www.federalreserve.gov/monetarypolicy/mainstreetlending.htm; Federal Reserve Bank of Boston, *Federal Reserve Bank of Boston releases additional information for potential lenders and borrowers in the Main Street Lending Program,* May 27, 2020, https://www.bostonfed.org/news-and-events/press-releases/2020/main-street-lending-program-additional-information-potential-lenders-borrowers.aspx; Federal Reserve Bank of Boston, *Main Street Lending Program Forms and Agreements,* available at: https://www.bostonfed.org/supervision-and-regulation/supervision/special-facilities/main-street-lending-program/information-for-lenders/docs.aspx.

[75] Board of Governors of the Federal Reserve System, *Federal Reserve Board expands its Main Street Lending Program to allow more small and medium-sized businesses to be able to receive support,* June 8, 2020, https://www.federalreserve.gov/newsevents/pressreleases/monetary20200608a.htm.

[76] *Id.*

[77] Federal Reserve Bank of Boston, *Federal Reserve's Main Street Lending Program opens for lender registration*, June 15, 2020, https://www.bostonfed.org/news-and-events/press-releases/2020/federal-reserves-main-street-lending-program-opens-for-lender-registration.aspx.

Main Street Facilities	MSNLF	MSPLF	MSELF
Type of Loan	New loans to borrowers	New loans to borrowers with greater leverage	Expanded loans to existing borrowers
Loan Term	5 years (*Previously 4 years)*		
Minimum Loan Size	$250,000 *(previously $500,000)*		$10 million
Maximum Loan Size	The lesser of $35 million, or an amount that, when added to outstanding and undrawn available debt, does not exceed 4 times that borrower's adjusted 2019 earnings before interest, taxes, depreciation, and amortization (EBITDA) (*previously $25 million)*	The lesser of $50 million, or an amount that, when added to outstanding or undrawn available debt, does not exceed 6 times the borrower's adjusted 2019 EBITDA (*previously $25 million*)	The lesser of $300 million, or an amount that, when added to outstanding or undrawn available debt, does not exceed 6 times the borrower's adjusted 2019 EBITDA (*previously $200 million*)
Loan Proceeds Can Repay Existing Debt	No	Yes	No
Lender's Risk Retention in Loan	5%	5% (*previously 15%)*	5%
Facilities Risk Retention in Loan	95%	95% (*previously 85%*)	95%
Principal Repayment Schedule	Principal deferred for 2 years. 15%, 15% and 70% principal repayment due in years 3, 4 and 5, respectively. (*Previously principal deferred for one year and 33.33% repayment due in years 2-4*)	Principal deferred for 2 years. 15%, 15% and 70% principal repayment due in years 3, 4 and 5, respectively. *(Previously principal deferred for one year and 15%, 15%, 70% repayment due in years 2, 3, and 4, respectively)*	
Deferral of Interest Payments	Interest payments deferred for one year		
Loan Rate	London Interbank Offered Rate (LIBOR) + 3%		

On June 15, the Federal Reserve announced it is seeking public feedback on a proposal to expand the Main Street Lending Program by establishing two facilities that are intended to

facilitate lending by banks to certain small and medium-sized nonprofit organizations.[78] As currently proposed, nonprofit organizations with at least 50 employees and up to 15,000 employees or up to $5 billion in 2019 revenues would be eligible to receive loans under these facilities.

Through the Nonprofit Organization New Loan Facility (NONLF), the Federal Reserve, through an SPV, would purchase a 95% stake in a loan originated after June 15, 2020 if: the loan has a 5-year maturity; payment of principal is deferred for two years; payment of interest is deferred for one year; the loan size is between $250,000 and the lesser of $35 million or the borrower's average 2019 quarterly revenue; and the interest rate is 300 basis points above the London Interbank Offered Rate (LIBOR).

Through the Nonprofit Organization Expanded Loan Facility (NOELF), the Federal Reserve, through an SPV, would purchase a 95% stake in a loan originated on or before June 15, 2020 with the same terms as through the NONLF, except that the maximum loan size is the lesser of $300 million or the borrower's average 2019 quarterly revenue.

The proposed term sheets for the NONLF and NOELF impose certain requirements on a borrower. These include that a borrower should make "reasonable efforts to maintain its payroll and retain its employees" while the Main Street loan is outstanding; that it will not use the proceeds of the loan to repay or refinance certain existing debts; and that it will follow executive compensation, stock repurchase, and capital distribution restrictions required under the CARES Act during the loan term and one year thereafter.

At this time, only a nonprofit organization that is a tax-exempt organization under section 501(c)(3) or 501(c)(19) of the Internal Revenue Code would be eligible for NONLF and NOELF.[79] However, at the discretion of the Federal Reserve, "other forms of organization may be considered for inclusion as a Nonprofit Organization" under the facilities.[80]

The Federal Reserve announced that it is seeking public feedback on the proposed facilities until June 22 "to help make the proposed program as efficient and effective as possible" because "the circumstances, structure, and needs of nonprofit organizations vary widely."[81] This feedback will be made available to the public, and comments should not include confidential information.

The chart below shows the key terms and conditions of the proposed NONLF and NOELF.

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[78] Board of Governors of the Federal Reserve System, *Federal Reserve Board announces it will be seeking public feedback on proposal to expand its Main Street Lending Program to provide access to credit for nonprofit organizations*, June 15, 2020, https://www.federalreserve.gov/newsevents/pressreleases/monetary20200615b.htm.
[79] Board of Governors of the Federal Reserve System, *Nonprofit Organization Expanded Loan Facility Draft Term Sheet*, June 15, 2020, https://www.federalreserve.gov/newsevents/pressreleases/files/monetary20200615b1.pdf.
[80] *Id*.
[81] Board of Governors of the Federal Reserve System, *Federal Reserve Board announces it will be seeking public feedback on proposal to expand its Main Street Lending Program to provide access to credit for nonprofit organizations*, June 15, 2020, https://www.federalreserve.gov/newsevents/pressreleases/monetary20200615b.htm.

Proposed Main Street Lending Program Nonprofit Loan Options	NONLF	NOELF
Type of Loan	New loans to borrowers	Expanded loans to existing borrowers
Term	5 years	
Minimum Loan Size	$250,000	$10 million
Endowment Cap	$3 billion	
Years in Operation	At least 5 years	
Employee Min/Max	Minimum of 50 employees and maximum of 50,000 employees	
Revenue Cap and Source Requirement	2019 revenues less than $5 billion, with less than 30% sourced from donations	
Maximum Loan Size	The lesser of $35 million, or the borrower's average 2019 quarterly revenue	The lesser of $300 million, or the borrower's average 2019 quarterly revenue
Lender's Risk Retention in Loan	5%	5%
Facilities Risk Retention in Loan	95%	95%
Principal Repayment Schedule	Principal deferred for 2 years. 15%, 15% and 70% principal repayment due in years 3, 4 and 5, respectively.	
Deferral of Interest Payments	Interest payments deferred for one year	
Loan Rate	London Interbank Offered Rate (LIBOR) + 3%	

Municipal Liquidity Facility (MLF)

The MLF is intended to help state and local governments manage cash flow problems relating to the COVID-19 crisis. The Federal Reserve, through an SPV, will purchase notes from U.S. states, including the District of Columbia, U.S. counties with a population of at least 500,000 residents, U.S. cities with a population of at least 250,000, and certain multistate entities. States may use the proceeds for the sales of these notes to support counties and cities. The Treasury has announced it intends to make an equity investment of $35 billion in this facility. The MLF can provide up to $500 billion in lending.[82]

[82] Board of Governors of the Federal Reserve, *Municipal Liquidity Facility Term Sheet,* June 3, 2020, https://www.federalreserve.gov/newsevents/pressreleases/files/monetary20200603a1.pdf; Federal Reserve Bank of New York, *FAQs: Municipal Liquidity Facility Term Sheet,* June 3, 2020, https://www.newyorkfed.org/markets/municipal-liquidity-facility/municipal-liquidity-facility-faq.

On May 19, Chair Powell testified before Congress that he expected the MLF to be operational by the end of May or the beginning of June.[83] The MLF became operational on May 26.[84]

On June 2, Illinois announced that it intended to borrow $1.2 billion from the MLF through the sale of one-year notes on June 5, making it the facility's inaugural participant.[85] Illinois will pay an interest rate of 3.82% on these notes. That is more than a full percentage point less than the 4.875% interest rate it paid on comparable short-term notes during a bond market sale in mid-May.[86]

On June 3, the Federal Reserve announced changes to the MLF to expand the "number and types of entities eligible to directly use the [MLF].[87] These changes included:

- Allowing all U.S. states to have at least two cities or counties directly issue notes to the MLF regardless of population.

- Authorizing governors of each state to designate two issuers in their states whose revenues "are generally derived from operating government activities (such as public transit, airports, toll facilities, and utilities) to be eligible to directly use the facility."[88]

As of June 10, Illinois is the only state or local government to borrow from the MLF.[89]

<u>Term Asset-Backed Securities Loan Facility (TALF)</u>

The TALF is intended to facilitate the provision of credit to consumers and businesses by enabling the issuance of asset-backed securities (ABS) "backed by private student loans, auto loans and leases, consumer and corporate credit card receivables, certain loans guaranteed by the Small Business Administration (SBA), and certain other assets."[90] The Federal Reserve, through

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[83] Senate Banking, Housing, and Urban Affairs Committee hearing on the Quarterly CARES Act Report to Congress, 116th Cong. (May 19, 2020) (statement of Jerome Powell, Chair, the Board of Governors of the Federal Reserve).
[84] Federal Reserve Bank of New York, *FAQs: Municipal Liquidity Facility*, June 3, 2020, https://www.newyorkfed.org/markets/municipal-liquidity-facility/municipal-liquidity-facility-faq.
[85] Shruti Singh & Amanda Albright, *Illinois Becomes First to Tap Fed Loans After Yields Surge,* Bloomberg, June 2, 2020, https://www.bloomberg.com/news/articles/2020-06-02/illinois-becomes-first-to-tap-fed-loans-after-bond-yields-surge.
[86] *Id.*; State of Illinois, *General Obligation of Bonds, Series of May 2020,* May 2020, https://www2.illinois.gov/sites/capitalmarkets/Documents/Official%20Statements/2020/State%20of%20Illinois-General%20Obligation%20Bonds%20Series%20of%20May%202020-Official%20Statement.pdf.
[87] Board of Governors of the Federal Reserve System, *Federal Reserve Board announces an expansion in the number and type of entities eligible to directly use its Municipal Liquidity Facility,* June 3, 2020, https://www.federalreserve.gov/newsevents/pressreleases/monetary20200603a.htm.
[88] *Id*.
[89] *See* note 17.
[90] Board of Governors of the Federal Reserve System, *Periodic Report Update on Outstanding Lending Facilities Authorized by the Board under Section 13(3) of the Federal Reserve Act*, May 28, 2020, https://www.federalreserve.gov/files/pmccf-smccf-talf-5-29-20.pdf#page=3.

an SPV, will "make loans to U.S. companies secured by certain AAA-rated [ABS] backed by recently originated consumer and business loans."[91] The Treasury has announced it intends to make an equity investment of $10 billion in this facility. The TALF can provide up to $100 billion in lending.[92]

On fixed days each month, known as subscription dates, borrowers will be able to request one or more three-year TALF loans. On May 20, the Federal Reserve Bank of New York announced that the first subscription date for TALF loans will be June 17 and the first loan closing date will be June 25.[93] As of June 17, the TALF was not yet operational.

Treasury Loans for the Airline Industry and National Security Businesses

The Treasury has not disbursed any of the $46 billion it can use to provide loans and loan guarantees to the airline industry and businesses critical to maintaining national security. While the Treasury has received applications for these loans and is in the process of reviewing them, it has not made any loans.

The Treasury has defined a "business critical to maintaining national security" as a business that is at the time of its application performing under a defense contract of the highest national priority or operating under a top secret facility security clearance.[94]

The Treasury has also stated that a business that does not satisfy either of these two criteria may be considered for loans if the Treasury Secretary determines that the business is critical to maintaining national security, based on a recommendation and certification by the Secretary of Defense or the Director of National Intelligence that it is.[95]

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[91] *Id*.

[92] Board of Governors of the Federal Reserve System, *Term Asset-Backed Securities Loan Facility,* May 12, 2020, https://www.federalreserve.gov/newsevents/pressreleases/files/monetary20200512a1.pdf.

[93] Federal Reserve Bank of New York, *New York Fed Announces the First Subscription Date of June 17 for the Term Asset-Backed Securities Loan Facility and Releases Additional Information,* May 20, 2020, https://www.newyorkfed.org/newsevents/news/markets/2020/20200520.

[94] U.S. Department of the Treasury, *Q&A: Loans to Air Carriers and Eligible Businesses and National Security Businesses,* Apr. 10, 2020, https://home.treasury.gov/system/files/136/CARES-Airline-Loan-Support-Q-and-A-national-security.pdf; Defense Contract Management Agency, *Defense Priorities & Allocations System (DPAS),* May 7, 2019, https://www.dcma.mil/DPAS/ ("A DX rating is assigned to those programs of the highest national priority").

[95] U.S. Department of the Treasury, *Q&A: Loans to Air Carriers and Eligible Businesses and National Security Businesses,* Apr. 10, 2020, https://home.treasury.gov/system/files/136/CARES-Airline-Loan-Support-Q-and-A-national-security.pdf.

On April 30, Undersecretary of Defense Ellen Lord stated that "a little less than 20 companies" had applied for the loans for businesses critical to maintaining national security as of that date, which was a day before the May 1 loan application deadline.[96]

On June 11, Treasury Secretary Steven Mnuchin told reporters the Treasury may modify the definition of a business considered critical to maintaining national security in order to widen access to loans.[97] He also stated the Treasury is "first processing the existing requests" for these loans and that a "large number of applications" were being reviewed, but he did not give a specific number or identify any specific businesses that had applied.[98]

Secretary Mnuchin noted that the Treasury anticipated Boeing Co. and General Electric Co. might apply for these loans, but neither business decided to apply for the loans.[99] On April 30, Boeing was able to raise $25 billion through a bond sale in the debt market.[100] Secretary Mnuchin went on to state that "[i]f for whatever reason we don't have enough demand, we may go back to Congress and reauthorize that for other areas."[101]

During the same June 11 press conference, Secretary Mnuchin also discussed the Subtitle A loan program for the airline industry. He said that some airlines have chosen to utilize the grant program in Division A, Title IV, Subtitle B of the CARES Act rather than the loans available through Subtitle A.[102] He stated the Treasury has told the airline industry they can access the loan program under Subtitle A "between now and the end of September."[103] He also stated that

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[96] Undersecretary of Defense for Acquisition and Sustainment Ellen M. Lord, *Undersecretary of Defense (A&S) Ellen Lord Holds a Press Briefing on COVID-19 Response Efforts,* U.S. Department of Defense, Apr. 30, 2020, https://www.defense.gov/Newsroom/Transcripts/Transcript/Article/2172171/undersecretary-of-defense-as-ellen-lord-holds-a-press-briefing-on-covid-19-resp/; Saleha Mohsin, *Mnuchin May Ease Rules for $17 Billion Security Funds,* Bloomberg, June 11, 2020, https://www.bloomberg.com/news/articles/2020-06-11/mnuchin-says-he-may-ease-rules-for-17-billion-security-stimulus.

[97] Saleha Mohsin, *Mnuchin May Ease Rules for $17 Billion Security Funds,* Bloomberg, June 11, 2020, https://www.bloomberg.com/news/articles/2020-06-11/mnuchin-says-he-may-ease-rules-for-17-billion-security-stimulus; David Lawder & David Shepardson, *U.S. Treasury's Mnuchin considering changes to aid for national security firms,* Reuters, June 11, 2020, https://www.reuters.com/article/health-coronavirus-defense/update-1-u-s-treasurys-mnuchin-considering-changes-to-aid-for-national-security-firms-idUSL1N2DO1SP.

[98] David Lawder & David Shepardson, *U.S. Treasury's Mnuchin considering changes to aid for national security firms,* Reuters, June 11, 2020, https://www.reuters.com/article/health-coronavirus-defense/update-1-u-s-treasurys-mnuchin-considering-changes-to-aid-for-national-security-firms-idUSL1N2DO1SP.

[99] Saleha Mohsin, *Mnuchin May Ease Rules for $17 Billion Security Funds,* Bloomberg, June 11, 2020, https://www.bloomberg.com/news/articles/2020-06-11/mnuchin-says-he-may-ease-rules-for-17-billion-security-stimulus; David Lawder & David Shepardson, *Update 1-U.S. Treasury's Mnuchin Considering changes to aid for national security firms,* Reuters, June 11, 2020, https://www.reuters.com/article/health-coronavirus-defense/update-1-u-s-treasurys-mnuchin-considering-changes-to-aid-for-national-security-firms-idUSL1N2DO1SP.

[100] Joshua Franklin & David Shepardson, *Boeing raises $25 billion in blowout debt sale, eschews government aid,* Apr. 30, 2020, https://www.reuters.com/article/us-boeing-debt/boeing-raises-25-billion-in-blowout-debt-sale-eschews-government-aid-idUSKBN22C3SJ.

[101] David Lawder & David Shepardson, *U.S. Treasury's Mnuchin considering changes to aid for national security firms,* Reuters, June 11, 2020, https://www.reuters.com/article/health-coronavirus-defense/update-1-u-s-treasurys-mnuchin-considering-changes-to-aid-for-national-security-firms-idUSL1N2DO1SP.

[102] *Id.*

[103] *Id.*

there "are detailed negotiations going on" with airline industry applicants concerning these loans.[104]

On June 12, American Airlines announced that it has applied for, and expects to obtain from the Treasury in June, an approximately $4.75 billion loan through Subtitle A's airline industry loan program.[105] The company noted, however, that it has not yet finalized the loan with the Treasury. American Airlines expects the loan to be "a five-year, senior secured obligation at a variable interest rate of LIBOR plus 3.50% and prepayable at any time without premium."[106] The company's current intention is to pledge its domestic loyalty program assets as security for this loan.[107] According to American Airlines, the "most recent third-party appraisal has estimated the value of [its loyalty program] to be between $19.5 billion and $31.5 billion."[108]

In connection with this loan, American Airlines would issue to the Treasury warrants to purchase approximately 38 million shares of the company's common stock at an exercise price of $12.51 per share. On June 17, the company's closing share price was $16.98. The warrants issued in connection with American Airlines' Subtitle A loan would be issued in addition to, and have the same terms, conditions, and exercise price as, the approximately 13.7 million warrants it expects to issue to the Treasury in connection with the $5.8 billion in funding it is receiving from the Treasury under the Payroll Support Program created by Division A, Title IV, Subtitle B of the CARES Act.[109]

In addition to American Airlines, multiple other airlines have publicly disclosed they intended to, or did apply for, the Treasury's Subtitle A loan program, including, among others, United Airlines, Southwest Airlines, and Jet Blue Airways.[110]

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[104] *Id.*
[105] American Airlines Group Inc., Current Report (Form 8-K), June 12, 2020, https://americanairlines.gcs-web.com/static-files/10598693-10e7-455b-9310-0072dd86c913.
[106] *Id.*
[107] *Id.*
[108] *Id.*
[109] American Airlines Group Inc., Current Report (Form 8-K), Apr. 14, 2020, https://americanairlines.gcs-web.com/static-files/18c94436-54b1-4593-aa1a-984734904a5f.
[110] United Airlines Holdings, Inc., Current Report (Form 8-K), Apr. 20, 2020, https://ir.united.com/static-files/440c2464-a618-4c55-afa0-4eaff0210d3e; Southwest Airlines Co.; Quarterly Report (Form 10-Q), April 28, 2020, http://otp.investis.com/clients/us/southwest/SEC/sec-show.aspx?FilingId=14098646&Cik=0000092380&Type=PDF&hasPdf=1; Jetblue Airways Corp., Quarterly Report (Form 10-Q), May 8, 2020, http://otp.investis.com/clients/us/jetblue_airways/SEC/sec-show.aspx?FilingId=14134706&Cik=0001158463&Type=PDF&hasPdf=1.

DISCUSSION OF TREASURY AND FEDERAL RESERVE'S ANSWERS TO THE COMMISSION'S QUESTIONS

This section of the report lists the tier 1 questions the Commission asked the Treasury and the Federal Reserve (the "agencies") to answer by June 8, followed by the agencies' answers and the Commission's discussion of those answers.

I. General Questions

1. How will Treasury and the Fed ("the agencies") assess the success or failure of this program?

The Board of Governors of the Federal Reserve System (the "Board"; together with the Federal Reserve Banks, the "Federal Reserve") with the support and approval of the Department of the Treasury ("Treasury"; together with the Federal Reserve, the "agencies") has established a set of lending facilities pursuant to the Coronavirus Aid, Relief, and Economic Security Act ("CARES Act") and under section 13(3) of the Federal Reserve Act (the "13(3) facilities"). The agencies created the 13(3) facilities in response to the unprecedented financial and economic strains imposed by the COVID-19 pandemic and by the public health measures employed in response. The agencies monitor a broad range of economic and financial indicators to judge economic activity, credit flows, and market functioning as a whole. The Federal Reserve designed the facilities to work together to protect financial stability and support achievement of its dual mandate of full employment and price stability.

Broadly speaking, the 13(3) facilities established with the support and approval of Treasury using funds made available by the CARES Act—the corporate credit facilities (the Primary Market Corporate Credit Facility ("PMCCF") and Secondary Market Corporate Credit Facility ("SMCCF")), the Main Street Lending Program (the Main Street New Loan Facility ("MSNLF"); the Main Street Priority Loan Facility ("MSPLF"); and the Main Street Expanded Loan Facility ("MSELF")); the Term Asset-Backed Securities Loan Facility ("TALF"); and the Municipal Liquidity Facility ("MLF")—have as their immediate goal the promotion of the flow of credit to businesses, households and state and local governments. The effectiveness of all these facilities is generally best measured by the degree to which the targeted market or area of the economy recovers by having the program present.

As noted, the agencies monitor a variety of indicators to assess the performance of the 13(3) facilities. With respect to short-term funding markets, among other indicators, we monitor issuance, maturity, outstandings and spreads for a range of money market instruments, including repurchase agreements, commercial paper, certificates of deposit, and variable-rate demand notes. We also measure pressures on key institutions and intermediaries in these markets, which include, but are not limited to, money market funds, commercial banks and dealers. Finally, we monitor the volume and key features of assets pledged to, or purchased by, these facilities as well as the counterparties to these transactions.

When judging the flow of credit to households, businesses, and state and local governments, we use similar metrics. Among these, we monitor the issuance, maturity, outstandings, and spreads for a wide range of debt instruments, including auto, credit card, and other consumer loans; loans to small businesses; syndicated loans; corporate bonds; municipal notes and bonds; and asset-backed securities. We also monitor measures of market functioning, such as bid-ask spreads, trading costs, order book depth, trading volumes, and price volatility. Moreover, the agencies monitor the health of key institutions and intermediaries in these credit markets, which include, but are not limited to, open-end mutual funds, commercial banks, and dealers. Finally, as these facilities come to operational readiness, we monitor the volume and key characteristics of loans made (or assets purchased) by these facilities, as well as the set of businesses and governmental entities (e.g., states and municipalities) using the facilities.

Commission Discussion:

The agencies have provided a helpful response on how they will measure the success of these emergency programs. Notably, the agencies state that the Federal Reserve designed the programs in a way that "protect[s] financial stability and support[s] achievement of [the Federal Reserve's] dual mandate of full employment and price stability." The agencies state that the "effectiveness of all these facilities" should not be measured by their effect on employment and price stability, but instead is "generally best measured by the degree to which the targeted market or area of the economy recovers by having the program present." We recommend that the agencies further clarify how they will evaluate the success of the emergency lending programs and facilities under Division A, Title IV, Subtitle A of the CARES Act ("Subtitle A").[111]

First, the agencies should consider expanding their evaluation framework to help guide decision-making and identify when to adjust course. To help in this regard, the agencies could clarify the following statement in their response:

- *The agencies state that the "effectiveness of all these facilities is generally best measured by the degree to which the targeted market or area of the economy recovers by having the program present."* First, the agencies should define what they mean by "recovers." Does it mean revert to its condition before the COVID-19 crisis or something else? What metrics will they evaluate to assess "recovery"? Second, the agencies should clarify how they plan to determine if an economic recovery is due to these programs. For example, are the agencies identifying a baseline economic recovery without the programs and comparing it to an economic recovery with the programs? If so, additional insight on the methodology behind such measurement would be valuable to the Commission. Third, we are interested to know the extent to which the timing and scope of economic recovery would be attributable to these programs. Fourth, the agencies should clarify both how the

[111] The Commission recognizes the agencies forthcoming answers to its tier 2 questions may address these matters.

presence of the emergency programs will impact economic recovery, even absent a high rate of participation in the programs.

Second, the agencies should consider distinguishing between leading indicators and long-term goals, which are achieved only through intermediary steps and do not provide timely feedback. For example, certain pieces of data may serve as leading indicators that speak to the health of the internal operations of a program. A lack of demand for a program could indicate a problem with program design or it could indicate that recovery is underway and the program is less necessary. Such information would be useful for the Commission and the public in understanding the effectiveness of the various programs and facilities.

2. The agencies are supposed to use this program to stabilize the economy and help companies and municipalities with liquidity issues stemming from the COVID-19 crisis. How will the agencies attempt to achieve this goal while protecting taxpayer dollars? Are the agencies prepared to lose taxpayer dollars in an effort to facilitate more lending and support to a broader set of entities?

In implementing the 13(3) facilities using the authority provided by the CARES Act, and under the Federal Reserve Act, the agencies are committed to addressing the severe economic dislocations that have occurred as a result of the impact of COVID-19. We have designed the 13(3) facilities to provide liquidity to solvent borrowers—businesses and states and municipalities—to better enable these organizations to either rehire their workers when the economy reopens or keep them on board. Consistent with the CARES Act, these facilities also are designed and implemented in compliance with section 13(3) of the Federal Reserve Act, which provides that the Federal Reserve is restricted to making loans that are secured to the satisfaction of the lending Reserve Bank and that carry sufficient credit protections to protect taxpayers from losses. Equity investments provided by Treasury, including equity investments made by Treasury using funds appropriated by Congress under the CARES Act, are designed to cover losses on loans made by the facility, including in downside economic scenarios—and thus inherently may take loss. Treasury accepts the possibility that losses may occur with respect to the funds it has committed, and believes that the terms and conditions of the 13(3) programs to which it has committed funds appropriately balance the interests of taxpayer protection and program efficacy.

We have focused to date on the most pressing needs for liquidity support in the U.S. economy. We are willing to adapt and extend these programs—or adopt additional programs—if appropriate to address the economy's evolving needs or our evolving understanding of its needs. The Federal Reserve expects that its loans made to fund the 13(3) facilities will be fully repaid under a very broad range of economic outcomes. The performance of Treasury equity investment in the 13(3) facilities will depend on program features and future economic conditions.

Commission Discussion:

The Commission appreciates that the agencies are "willing to adapt and extend" the emergency lending facilities, or create new ones, "if appropriate to address the economy's evolving needs." We also appreciate the agencies' clear commitment to comply with the restrictions on emergency lending in Section 13(3) of the Federal Reserve Act. However, we encourage the agencies to provide additional information on three matters.

First, we recommend that the agencies further clarify how they are determining whether to adapt facilities or create new ones to "address the economy's evolving needs." We are interested to know whether and how the agencies are working to identify if there are business sectors with creditworthy companies in need of lending that are not eligible for any of the emergency lending programs and facilities. We are also interested to know whether and how the agencies are working to identify if there are state and local governments in need of lending that may not be able to take advantage of the MLF. If there are business sectors or municipal governments that fall into such a gap, the Commission is interested to know whether and how the agencies will consider modifying the design of existing facilities, or creating new facilities, to address this gap, such as by modifying the amount of the Treasury's equity investment in a facility or by revising the terms of the facility.

Second, the Commission recommends that the agencies further clarify how they are deciding to invest economic stabilization funds provided under Subtitle A in the Federal Reserve's various lending facilities. Of particular importance is clarifying how much of the funds they are willing to allocate and lose, under what conditions, and whether and how they will decide to allocate the Treasury's remaining funds provided by Subtitle A.

- *To that end, the agencies should elaborate on the meaning of the statutory restrictions on emergency lending under Section 13(3) of the Federal Reserve Act.* The agencies state that 13(3) emergency loans must be "secured to the satisfaction of the lending Reserve Bank." The agencies should elaborate on the characteristics of a satisfactorily secured loan. For example, are all loans made from a facility in which the Treasury has made an investment sufficiently secured? If not, what types of features should be present in a loan beyond the requirement that the Treasury's investment in a facility cover all losses?

  The agencies stated that 13(3) loans must "carry sufficient credit protections to protect taxpayers from losses." However, the agencies should clarify what credit protections could be sufficient. As with the previous restriction, they should also clarify how the Treasury's investments in the Federal Reserve's lending facilities interact with this requirement.

Third, the Commission recommends that the agencies provide additional information about how they assess the risk of loss in the emergency lending facilities.

- *The agencies should provide further details on the economic scenarios that they use to assess risk.* For example, do these include economic scenarios for both a COVID-19 second wave and a faster-paced economic reopening? If the agencies have conducted projections of different economic scenarios to arrive at their decisions about the appropriate level of Treasury investment, the Commission requests that the agencies provide information about those projections.

II. Program and Facility-Specific Questions

A. Primary Market Corporate Credit Facility (PMCCF)

1. How did the agencies determine the eligible assets for purchase by this facility?

Under the PMCCF term sheet, there are two groups of eligible assets. First, the PMCCF may purchase eligible corporate bonds as the sole investor in a bond issuance. Second, the PMCCF may purchase portions of syndicated loans or bond issuances of eligible issuers at issuance; the PMCCF may purchase no more than 25 percent of any such loan syndication or bond issuance.

The agencies established the PMCCF to ensure that creditworthy companies that rely on capital markets to fund their operations have access to credit during the current unusual and exigent circumstances in which financial markets are experiencing extraordinary disruptions, volatility, and illiquidity. Corporate bonds support the operations of companies with more than 17 million employees based in the United States, and these bonds are key investment assets for retirees and pension funds. If companies are unable to issue corporate bonds, they may be unable to invest in inventory and equipment, meet current liabilities, or pay employees. The PMCCF seeks to ensure that creditworthy companies with maturing capital markets instruments (namely, syndicated loans and corporate bonds) retain the ability to refinance debt as well as access additional credit to ensure liquidity through this unprecedented period of COVID-19- related disruption.

Since the PMCCF's goal is to provide general support to creditworthy companies, and not to select among different industries and companies, the PMCCF utilizes a broad, transparent and simple ratings-based eligibility standard. In addition, since depository institutions and depository institution holding companies have access to other sources of support, their debt instruments are excluded from eligibility, as are companies that received specific lending support from Treasury under the CARES Act. Finally, because the equity provided to the PMCCF by the Treasury includes funds appropriated under the CARES Act, companies that participate in the PMCCF must comply with the U.S. business, conflict company, and other applicable CARES Act requirements.

Commission Discussion:

The agencies have provided a helpful response as to how they determined the eligible assets for purchase by the PMCCF. The Federal Reserve's March 23 announcement of the PMCCF, SMCCF, and several other lending facilities helped to stabilize the corporate bond market.[112] Even though the PMCCF is still not operational, since the late March announcement of these facilities, U.S. corporate bond issuance has been robust, which has enabled some businesses, particularly investment grade ones, to access credit to fund their operations. In both April and May, more than $300 billion of new U.S. corporate bonds were issued by investment grade and non-investment grade issuers, far outpacing the $105 billion and $130 billion in issuances in April and May 2019, respectively. Given these developments, we recommend the agencies continue to monitor conditions in the corporate bond market to evaluate the extent to which they will need to utilize the PMCCF. We are also interested to know why the agencies decided the PMCCF would purchase no more than 25% percent of a loan syndication or bond issuance when it purchases a portion of a syndicated loan or bond issuance.

2. Why did the agencies require an issuer to be rated investment grade by the credit rating agencies as of March 22, 2020, to be an eligible issuer for this facility? What would be the implications of broadening eligibility to this facility to issuers rated non-investment grade?

The PMCCF seeks to support creditworthy companies that rely on capital markets to fund their operations during unusual and exigent circumstances. Section 13(3) of the Federal Reserve Act and the Board's Regulation A require that a lending Reserve Bank secure itself to its satisfaction and ensure protection of the taxpayer. A historical investment-grade rating reflects positively on the creditworthiness of a firm prior to the unprecedented period of COVID-19-related disruption. Issuers that are rated investment grade have historically realized default rates that are significantly lower than issuers rated non-investment grade. Therefore, acquiring capital markets instruments of investment-grade issuers provides greater security than acquiring capital markets instruments of non-investment-grade issuers.

If the eligibility criteria of the PMCCF were broadened to include issuers that were not rated investment grade as of March 22, 2020, the number of companies eligible to obtain credit from the PMCCF would increase. Such an expansion, however, would increase the credit risk to the PMCCF at a rate greater than the proportionate increase in potential borrowers, due to the higher leverage and default risk of high-yield borrowers.

[112] Molly Smith, *U.S. Corporate Bond Sales Smash Record, Soaring Over $1 Trillion*, Bloomberg, May 28, 2020, https://www.bloomberg.com/news/articles/2020-05-28/fed-fueled-borrowing-binge-hits-1-trillion-mark-at-record-rate; Patti Domm, *The Fed thawed debt market and big companies built a $500 billion war chest to fight the virus*, CNBC, May 11, 2020, https://www.cnbc.com/2020/05/11/the-fed-thawed-debt-market-and-big-companies-built-a-500-billion-war-chest-to-fight-the-virus.html.

Commission Discussion:

The agencies have provided a helpful response as to how they determined the credit rating eligibility criteria for issuers for the PMCCF. As discussed above, since the Federal Reserve announced the PMCCF, SMCCF, and other lending facilities on March 23, U.S. corporate bond issuance has been robust. In April and May, almost 90% of the U.S. corporate bond issuances were from investment grade companies, while the rest were from non-investment grade companies. Because some investment grade issuers have been able to access credit through the corporate bond market, the number of potential investment grade borrowers from the PMCCF has likely declined.

Given this, the agencies should elaborate on the extent to which the Federal Reserve's legal requirements on adequate security and taxpayer protection prohibit the agencies from broadening the PMCCF's credit rating eligibility criteria to support more non-investment grade companies. As part of that explanation, the agencies should discuss both the CARES Act authorization for the Treasury to make loans, loan guarantees, and other investments meant to provide liquidity to businesses experiencing losses incurred as a result of the COVID-19 crisis, and the implications for future market behavior that could come from assisting non-investment grade issuers. Within this context, the agencies should further clarify whether a larger Treasury equity investment in the PMCCF would enable the Federal Reserve to broaden access to the facility to additional non-investment grade companies while still adhering to its aforementioned legal requirements. The Commission expects that the agencies will receive requests to expand the PMCCF, and answering these questions will help the agencies respond fairly to those requests.

3. Why did the agencies choose March 22, 2020, as the cutoff date for an issuer to be rated investment grade to be an eligible issuer for this facility? How will this date selection impact the ability of issuers that have been downgraded from investment grade to non-investment grade to access capital through this facility?

The two corporate credit facilities were initially authorized by the Board and approved by the Secretary of the Treasury on March 22, 2020. That cut-off date was chosen for the ratings criteria in order to extend the reach of the facilities to include all companies eligible at the announcement date, regardless of how long it would take to operationalize the facilities.

Issuers that were investment grade prior to March 22, 2020, but were subsequently downgraded, may still be eligible to access the PMCCF. They must be rated at least BB-/Ba3 as of the date on which the PMCCF makes a purchase. If rated by multiple major NRSROs, such issuers must be rated at least BB-/Ba3 by two or more NRSROs at the time the PMCCF makes a purchase.

Commission Discussion:

We appreciate the agencies' response as to how they determined the March 22 cutoff date and why they allowed some issuers downgraded to non-investment grade after March 22 the opportunity to access the PMCCF. As the agencies noted, an issuer that was rated investment grade as of March 22 but is subsequently downgraded to non-investment grade may still be eligible for the PMCCF if it is rated at least BB-/Ba3.

The Commission would like to know if the agencies have considered the costs and benefits of broadening the PMCCF to non-investment grade issuers prior to March 22 or changing the eligibility thresholds for downgraded issuers. As the agencies noted in their answer to question II.B.2 below, discontinuities between investment grade and non-investment grade markets "can lead to extreme outcomes where companies downgraded a single notch—from low investment-grade to the upper end of high-yield—find themselves facing sharply higher funding costs and thus are under increased pressure to cut costs, including by reducing their workforces." We want to ensure the relative risks borne by the agencies and the risks of changing the credit rating eligibility standards are balanced against the CARES Act goal of economic stabilization.

4. Why did the agencies limit eligible issuers to those rated by a major nationally recognized statistical rating organization (NRSRO) as opposed to issuers rated by other credit rating organizations?

The PMCCF uses ratings to evaluate the credit quality of companies in order to determine whether they may access the facility. To enable a quick launch, the PMCCF originally relied on the three NRSROs that the largest number of investors rely on. After conducting additional analysis, the facility recently added another three rating agencies to the list of eligible NRSROs. In assessing which rating agencies to deem eligible, the agencies analyzed a wide range of factors, including the extent to which an individual rating agency is relied upon by private-sector investors with respect to the relevant asset classes.

Commission Discussion:

The agencies have provided a helpful response as to how they determined the initial list of eligible NRSROs and the subsequent additions to that list. We are interested in whether the agencies have identified any business sectors with creditworthy companies that are ineligible for the PMCCF because they have ratings from credit rating organizations not on this list and whether it would be appropriate to further modify the list to address this issue.

B. Secondary Market Corporate Credit Facility (SMCCF)

1. Is there a concern that changes in secondary market bond prices will reduce the flow of credit to households and businesses or create risk to the financial system? If so, how and what is the strategy for using this facility to address that concern?

Since the onset of the COVID-19 pandemic, the corporate bond market has experienced significant dislocations. By facilitating market functioning, the SMCCF is intended to reduce the risk that secondary market prices for corporate bonds become subject to fire sales or price dislocations. These price dislocations are important because they affect the primary markets for American companies to access capital. Potential buyers may purchase bonds sold at distressed prices in the secondary market rather than buying newly issued bonds directly from companies, reducing the availability of new credit to fund companies. By providing support to the secondary market, the SMCCF reduces the cost of credit and increases the availability of credit to borrowers who might otherwise not be able to access the market with new corporate bond issuances at reasonable rates. In addition, there is a direct relationship between the secondary market and the primary market, as most new corporate bond prices are set based on secondary market spreads.

Commission Discussion:

We acknowledge the agencies' response about the important link between a functioning secondary market for corporate bonds and the ability of companies to access credit through the primary market for bonds. However, if the goal of the SMCCF is to ensure that creditworthy companies can access capital on the primary market at reasonable rates, it is unclear why the PMCCF alone does not serve that function. The agencies should elaborate as to why they need a SMCCF in addition to the PMCCF, and the rationale for the SMCCF's indexing approach to individual corporate bond purchases (when bond ETFs already exist), as announced on June 15. This explanation is particularly important given that the SMCCF has reduced spreads and, as discussed in the Commission's analysis of question II.A.1, the corporate bond market is functioning smoothly.

With liquidity restored and robust issuance of new corporate debt in April and May at low yields, the agencies should explain why they believe there is a continued need for SMCCF purchases. As the agencies operate the SMCCF, we recommend that they consider how to best distinguish between a functioning market and a non-functioning market. Their views on this matter will help determine how much and how long they will need to use the SMCCF to facilitate market functioning. The agencies should bear in mind that the Federal Reserve's emergency lending powers are statutorily limited to "unusual and exigent circumstances."[113] The COVID-19 crisis clearly created such circumstances. However, it is important that the Federal Reserve's use of these emergency powers not extend for a longer period of time than is necessary.

[113] 12 U.S.C. § 343(3) (Section 13(3) of the Federal Reserve Act).

2. On May 4, the Federal Reserve Bank of New York announced that it plans to use this facilityto purchase exchange-traded funds (ETFs) that may own bonds rated below investment grade. How did the Fed reach this decision and how does it measure the trade-offs of purchasing such ETFs?

Market functioning in the corporate credit market has been impaired based on metrics such as prices, bid ask spreads, trading volumes, and price volatility as well as limited primary market issuance from high-yield issuers. By purchasing ETFs that have exposure to high-yield issuers, the SMCCF seeks to provide support to the more dislocated segments of the corporate bond market and to limit discontinuities between the different segments of the market. Such discontinuities can lead to extreme outcomes where companies downgraded a single notch—from low investment-grade to the upper end of high-yield—find themselves facing sharply higher funding costs and thus are under increased pressure to cut costs, including by reducing their workforces. The increased risk associated with acquiring instruments issued by high-yield companies is managed by investing through instruments that allow for the creation of a diversified portfolio and by the increased amount of Treasury's equity allocated to support these purchases. The agencies also limit the amount of risk to the SMCCF from purchases of high- yield ETFs by ensuring that the large majority of ETF purchases target the investment-grade corporate bond market.

Commission Discussion:

The agencies have provided a helpful response explaining their rationale for using the SMCCF to purchase ETFs that may own bonds from non-investment grade companies. By purchasing ETFs that own bonds from non-investment grade companies, the agencies are tangentially altering the investment grade standard they have set for the PMCCF. The agencies should explain how they evaluate the implications of that decision—including whether they have analyzed which types of investors hold this debt—and how they weigh the potential costs of that approach against the benefits.

As the agencies note in their answer, discontinuities between the investment grade and non-investment grade bond markets "can lead to extreme outcomes where companies downgraded a single notch—from low investment-grade to the upper end of high-yield—find themselves facing sharply higher funding costs and thus are under increased pressure to cut costs, including by reducing their workforces." The agencies should clarify whether the rationale for using the SCMMF to purchase ETFs with bonds from non-investment grade companies also applies to the PMCCF.

The agencies stated that they manage the increased risk associated with purchasing ETFs containing non-investment grade bonds by creating a diversified portfolio, allocating more of the Treasury's equity investment in the SMCCF to support these purchases, and ensuring that the large majority of the SMCCF's purchases target investment grade bonds. We ask that they

explain the costs and benefits of using a similar risk management approach with the PMCCF if they allow additional non-investment grade companies to access that facility.

3. The Fed has hired the firm BlackRock to serve as an investment manager for this facility. How is the Fed ensuring BlackRock is acting in the best interest of the Fed and the public?

On May 11, 2020, Corporate Credit Facilities LLC ("CCF"), a special purpose vehicle created to facilitate the operations of SMCCF, entered into an Investment Management Agreement ("IMA") with BlackRock Financial Management, Inc. ("BlackRock"). The Federal Reserve Bank of New York ("FRBNY") is the sole managing member of the CCF.

Pursuant to the IMA, BlackRock acts as a fiduciary to the CCF in performing investment management services. In order to best advance the CCF's objectives as a fiduciary, BlackRock is required to follow FRBNY's specific and detailed investment guidelines and to buy and sell corporate bonds, corporate loans, and corporate bond ETFs on a best execution basis. BlackRock is required to communicate with the CCF on a daily basis regarding its planned purchase activity for the day and respond to requests for updates from the CCF on market functioning and asset purchases.

The IMA imposes stringent requirements on BlackRock to protect confidential information and to mitigate conflicts of interest. Confidential information gained by BlackRock or its affiliates or their respective directors, officers, or employees in the course of this engagement may not be leveraged for matters unrelated to the CCF. BlackRock's compliance with the rigorous information barrier and conflict of interest mitigation provisions the Federal Reserve has imposed under the IMA is subject to audit and review by FRBNY, the Board, and other governmental authorities with oversight responsibilities under applicable law.

These are select examples of provisions relating to the Federal Reserve's efforts to ensure that Blackrock is acting in the best interest of the public. The IMA, including the investment guidelines, is available in full on the FRBNY website. *See* https://www.newyorkfed.org/medialibrary/media/markets/SMCCF Investment Management A greement.pdf.

Commission Discussion:

The Commission appreciates that the agencies highlighted in this response certain provisions in BlackRock's Investment Management Agreement (IMA) that relate to the Federal Reserve's efforts to ensure that Blackrock is acting in the best interest of the public. We strongly encourage the Federal Reserve to act diligently to promote BlackRock's compliance with these provisions and all related provisions in the IMA. The Commission also recognizes that the hiring of BlackRock to provide investment advice also could confer certain benefits on BlackRock that are

not addressed in the IMA.[114] We ask the Federal Reserve to elaborate on why it chose BlackRock through a non-competitive process to provide investment advice.

4. Does Blackrock have a duty of best execution to the Fed?

Yes. The Operating Guidelines set out in the IMA provide that "[a]ll transactions in Eligible ETFs will be effected through Eligible Sellers at market prices on a best execution basis in accordance with [the IMA], whether in the secondary market or via primary creations and redemptions."

Commission Discussion:

The Commission appreciates the response. We strongly encourage the Federal Reserve to act diligently to promote BlackRock's compliance with this provision.

5. BlackRock has entered into a contract with the New York Federal Reserve Bank to provide management and advisory services to the facility. In that role, BlackRock employees will have access to material non-public information. Per the contract, certain BlackRock executives with access to that information will have the ability to provide "investment management, trading, and/or advisory services to other clients with respect to securities other than corporate bonds, ETFs, equity securities, or derivatives the value of which are tied to such instruments, including providing general market views and market views related to securities other than corporate bonds, ETFs, equity securities, or derivatives the value of which are tied to such instruments." They are also permitted to provide "investment management, trading or advisory services" in any asset class and to purchase investments for themselves in any asset class after a two-week cooling-off period.

- ***a. Why is two weeks an appropriate cooling-off period?***

- ***b. How will any breaches of the non-public information be reported? What will be the discipline for such breaches?***

The IMA provides stringent requirements to protect confidential information and to mitigate conflicts of interest. Confidential information gained by BlackRock or its affiliates or their respective directors, officers, or employees in the course of this engagement may not be leveraged for matters unrelated to the CCF. This restriction prohibits, without limitation, use of any confidential information for the benefit of BlackRock, for the benefit of any other BlackRock client, or to inform any financial transaction, render any advice or recommendation, or attempt to influence any market or transaction for the benefit of any individual or entity other than the CCF. This obligation survives the termination or expiration of the IMA.

[114] Chris Flood, *BlackRock trounces ETF rivals after Fed appointment*, Financial Times, May 20, 2020, https://www.ft.com/content/7091a2a5-7eef-4c78-8331-9fd986925f8a.

The “two-week cooling off period” relates to the information wall between BlackRock employees who are involved in providing investment management, trading, and/or advisory services to the CCF or FRBNY and other BlackRock employees. BlackRock employees providing such services to the CCF or FRBNY—for the duration of when they have access to material nonpublic information plus a two week cooling off period—are prohibited from providing investment management, trading, or advisory services to anyone other than the CCF in any of the asset classes held by BlackRock and must also refrain from purchasing for him/herself investments in any of the asset classes held by BlackRock, unless authorized by the Chief Compliance Officer of FRBNY. The two-week period is intended to ensure that material nonpublic information loses its value in the market. To be clear, even after the two-week cooling off period, material nonpublic information may not be leveraged for matters unrelated to the CCF. Additional information is available in Exhibit G to the IMA, which sets forth the Information Barrier and Conflicts of Interest Mitigation Procedures. *See* https://www.newyorkfed.org/medialibrary/media/markets/SMCCF_Investment_Management_A greement.pdf.

The IMA requires that breaches of confidential information be reported promptly. Should a breach occur, FRBNY will respond with diligence and promptness. Consequences for any breach will be determined by the Federal Reserve.

Commission Discussion:

The Commission appreciates that the agencies highlighted in this response provisions of the IMA that seek to protect confidential information and mitigate conflicts of interest. We strongly encourage the Federal Reserve to act diligently to promote BlackRock’s compliance with these provisions and to respond appropriately if they are breached.

C. Main Street Lending Program

1. ***Why did the agencies choose the 85% and 95% purchase rates for the SPVs in this program?***

The Main Street SPV will purchase participations in MSNLF loans, MSPLF loans, and MSELF upsized tranches. The agencies considered several factors in sizing participations in Main Street eligible loans and upsized tranches. The agencies created Main Street facilities that purchase sizable (but less than 100 percent) participations in loans in order to maintain a level of risk sharing that limits downside risk and creates balance sheet capacity for eligible lenders, while at the same time ensuring eligible lenders have a strong incentive to apply prudent underwriting and risk management standards. Upon full consideration of the relevant factors, the agencies believe that a 95 percent participation provides an appropriate balance of these considerations for all three Main Street facilities. Accordingly, on June 8 the Board issued revised term sheets that, among other changes, specify a 95% participation percentage for MSPLF loans (up from 85%), while maintaining the 95% participation percentage for MSNLF and MSELF loans.

Commission Discussion:

The Commission appreciates that the agencies are striving to find an "appropriate balance" between limiting "downside risk" for lenders and encouraging "prudent underwriting and risk management standards." In their response, the agencies highlight the reduction of the lender risk retention in loans under the MSPLF from 15% to 5%. The agencies should consider whether to modify loan terms or the standard for determining maximum loan size in exchange for higher risk retention by lenders. This approach appears to be consistent with the original rationale for the MSPLF, which required lenders to retain 15% of a loan but allowed for potentially riskier loans. The original 15% risk retention ensured that lenders would share more in any losses and thus provided greater protection for taxpayer funds. It also encouraged lenders to apply prudent underwriting and risk management practices for these potentially riskier loans. The Commission is also interested in learning if the agencies have considered other changes to the loan terms (origination fees, servicing fees, etc.) that would better incentivize banks to make loans and reach as many businesses as possible that need additional credit.

2. Why did the agencies choose the employee-size and annual revenue criteria that determine which businesses are eligible for this program?

Employee size and annual revenue criteria are used for the Small Business Administration's (SBA) 7(a) program and Payroll Protection Program ("PPP") and are commonly used to measure the footprint of a business. The adoption of such metrics was considered prudent, because the program is designed to support small and medium-sized businesses that are unable to receive sufficient assistance through other programs, such as the SBA's PPP, and that lack access to the Federal Reserve's Primary and Secondary Market Corporate Credit Facilities. The agencies set the employee and revenue criteria for the Main Street Lending Program to provide broad access to companies that lack access to or sufficient support from other existing programs and were otherwise in sound financial condition prior to the crisis.

The agencies have not set a lower bound "floor" for borrower size under the program, thereby providing access to small businesses that met other program criteria. The upper bounds for the employee-size and annual revenue criteria were raised from 10,000 employees or $2.5 billion in revenues to 15,000 employees or $5 billion in revenues in response to public feedback that the lower levels initially proposed would have scoped out businesses that could benefit from Main Street loans. The changes were also intended to provide a better congruence with the PMCCF and SMCCF by capturing a wider swath of companies that may not have reached the scale needed to issue the kinds of capital market instruments that would be purchased under the PMCCF and SMCCF.

Commission Discussion:

The agencies have provided a helpful response explaining their rationale for the employee-size and annual revenue criteria that determine which businesses are eligible for the Main Street

Lending Program. As the Main Street Lending Program and PMCCF become operational, we recommend the agencies monitor whether there are businesses in need of credit who are too big to access the Main Street Lending Program but too small to access the PMCCF. If the agencies discover that there are, they should consider modifying the employee-size and annual revenue criteria for the Main Street Lending Program—along with making any other appropriate modifications to minimize downside risk and encourage prudent underwriting—so that such businesses have an opportunity to access credit from at least one of the Federal Reserve's emergency lending facilities.

3. How did the agencies choose the minimum loan sizes for the facilities in this program?

The agencies considered several factors in determining minimum loan sizes. Consistent with the desire to assist companies that may have received insufficient support through the PPP or that are unable to receive support through the PMCCF or SMCCF, the Main Street Lending Program targeted a minimum loan size that would be attractive to a broad range of small and medium-sized businesses that may not have been able to receive support from these other programs. The agencies also had a desire to maintain sufficient overlap with the upper bound of the PPP in order to avoid excluding inadvertently a set of businesses from assistance. The agencies considered public feedback received and, in the revised term sheets issued on June 8, have selected $250,000 (lowered from $500,000) as the minimum loan size for the MSNLF and MSPLF in an effort to make the Main Street Lending Program accessible to as many borrowers as possible, while ensuring the program is feasible from an operational perspective.

The minimum loan size of the MSELF, at $10 million, was set significantly higher than that of the MSNLF or MSPLF because MSELF upsized tranches are likely more attractive to larger, more sophisticated borrowers with more complex funding structures.

Commission Discussion:

The agencies have provided a helpful response explaining their rationale for the minimum loan sizes for the Main Street facilities and their modifications to those minimum loan sizes. We acknowledge that the agencies have already been willing to make modifications to the minimum loan sizes in response to public feedback they received. When the Main Street facilities become operational, the agencies should closely monitor whether the minimum loan sizes have been set appropriately to allow small and medium-sized businesses in need of credit to access the Main Street facilities. If the minimum loan sizes have not been set appropriately, we encourage the agencies to identify the types of companies that are unable to access support and to consider modifying the minimum loan sizes accordingly.

4. Why did the agencies decide not to create the mid-sized business lending facility that is described but not mandated in Section 4003(c)(3)(D) of the CARES Act?

The agencies designed the Main Street Lending Program to meet the needs of small and

medium-sized businesses as effectively and efficiently as possible, while protecting taxpayer funds. The program is designed within the parameters of Section 13(3) of the Federal Reserve Act, the CARES Act, and the Board's Regulation A, and includes CARES Act restrictions on executive compensation, capital distributions, and equity repurchases. The program includes a number of features that are designed to be attractive to small and medium-sized businesses, including deferral of interest payments for one year and deferral of repayment of principal for two years.

Commission Discussion:

The response seems to suggest that the agencies did not think the mid-sized business facility described in the CARES Act would effectively and efficiently meet the needs of small and medium-sized businesses or be attractive to such businesses. The Commission requests that the agencies explain why they determined the program recommended in the CARES Act would not have effectively met the needs of such companies.

5. What is the agencies' rationale for the adjusted earnings before interest, taxes, depreciation, and amortization (EBITDA) and leverage standards for loans in this program?

Fundamentally, the agencies decided to use a leverage test based on EBITDA as the key parameter to govern the credit risk assumed by the Main Street Lending Program. The use of EBITDA and leverage requirements is standard industry practice in evaluating a potential borrower's creditworthiness for cash flow-based lending. Lenders and borrowers regularly agree to adjust a borrower's EBITDA to accommodate differences in business models across industries and to accommodate one-time events that may positively or negatively impact a borrower's earnings. When applied prudently, these adjustments provide a lender with a more accurate representation of a business's earnings capacity over time.

Allowing for leverage of 4x or 6x adjusted EBITDA is within the normal range of practice across the banking industry. The agencies determined that leverage of 4x adjusted EBITDA is reasonable for the MSNLF given the parameters of MSNLF Loans, but they allowed for greater leverage within the MSELF and MSPLF because other risk mitigating features and protections exist in those facilities, such as the additional security required in the MSELF and the larger risk retention requirement in the MSPLF.

Commission Discussion:

We appreciate the agencies' explanation of their rationale for the EBITDA standards for loans in the Main Street facilities. But we note that some stakeholders have raised concerns that the EBITDA standard for the MSNLF is too burdensome and will prevent some creditworthy small and medium-sized businesses from obtaining Main Street loans. The agencies should elaborate as to whether these businesses are in need of financing from the Main Street facilities

or have been able to adequately obtain capital elsewhere.

The agencies' response justifies the higher EBITDA standard for the MSPLF on the ground that the MSPLF has a larger risk retention requirement for lenders (15%), which mitigates the risk of loss for the facility. However, on June 8, the Federal Reserve announced that the MSPLF's risk retention requirement for lenders would be lowered to 5%, making it the same as the risk retention requirement for the MSNLF and MSELF. In light of this modification, what are the costs and benefits of raising the EBITDA standard for the MSNLF? In addition, when the Main Street facilities become operational the agencies should monitor whether the EBITDA standards have been set appropriately to allow creditworthy small and medium-sized businesses in need of financing to access the Main Street facilities. For instance, we are interested to know if the agencies have identified industries with businesses that generally do not meet the EBITDA standards for the Main Street facilities because of the nature of their industries but are nonetheless creditworthy.

6. Between the initial announcement of the Main Street facilities on April 9 and the modifications to the facilities the Fed announced on April 30, the Fed reportedly received more than 2,200 comments from experts, industry groups, and others. Will the Fed release those comments so the public can review them?

The agencies received more than 2,200 comments from small and medium-sized business owners, industry groups, nonprofit organizations, and lenders between April 9 and April 30. After reviewing the comments received, the agencies expanded many aspects of the Main Street Lending Program to make credit available to a greater number of small and medium-sized businesses across the country. We are in the process of preparing the comments received for public release by removing certain proprietary commercial and personally identifiable information. We anticipate releasing the comments to the public by the end of the month.

Commission Discussion:

We welcome the agencies' willingness to release these comments to the public. The release of these comments will help to promote transparency concerning the design of the Main Street Lending Program. The agencies should work diligently in preparing these comments for public release so that they can be released in June. We ask that the comments be released in searchable form, if possible, so that the public can review relevant comments efficiently.

7. As part of its April 30 revisions to the facility term sheets for this program, the agencies removed the requirement that companies attest that they require financing "due to the exigent circumstances presented by the coronavirus disease."

> ***a. Why did the agencies remove that requirement?***
>
> ***b. Without this requirement, how will the agencies ensure they are providing liquidity "to eligible businesses, [s]tates, and municipalities related to losses incurred as a result of coronavirus"?***

Nearly all sectors of the U.S. economy have been affected directly or indirectly by the exigent circumstances presented by the coronavirus pandemic. As adopted following the expiration of the public comment period, the Main Street Lending Program includes key features that more directly and effectively target credit to borrowers that have experienced a change in circumstances over the past several months. For example, while an eligible borrower's loans outstanding with the eligible lender must have received an internal risk rating that is equivalent to a "pass" rating used by supervisors, the term sheets intentionally specify that the relevant "as of" date for assignment of that rating is December 31, 2019—a date that precedes the onset of the COVID-19 disruption in the United States. In similar fashion, the mandatory Main Street borrower certification requires borrowers to attest that they (i) had generally been paying their undisputed debts due during the 90 days preceding the Main Street loan (unless the borrower is behind on its obligations because of disruptions to its business caused by the COVID-19 pandemic), and (ii) will be in a position following receipt of the Main Street loan to bring current any debts that have fallen into arrears during the period of COVID-19 disruption. These program features are designed to make Main Street funding available to businesses that were in sound financial condition prior to the onset of the pandemic, but that may need additional financing to support operations until conditions normalize.

Commission Discussion:

We appreciate that the agencies have incorporated into the Main Street Lending Program features to ensure loans are going to businesses that were in sound financial condition prior to the onset of the COVID-19 pandemic. But the agencies' response does not address how they are ensuring that a business applying for a Main Street loan needs financing due to the exigent circumstances presented by the COVID-19 pandemic. We also understand, as the agencies note, that "[n]early all sectors of the U.S. economy have been affected directly or indirectly by the exigent circumstances presented by the coronavirus pandemic." But that does not mean that every *business* in the U.S. economy is in need of financing due to exigent circumstances caused by the COVID-19 pandemic. In light of these issues, the Commission requests that the agencies elaborate on why they eliminated this attestation, including explaining whether there were companies that could have otherwise met the standards currently in the Main Street program but for the attestation in the original term sheet.

8. As part of its April 30 revisions to the facility term sheets for this program, the agencies eliminated the requirement that firms attest to making "reasonable efforts" to maintain payroll and retain employees during the term of the loan and replaced it with a requirement that firms should make "commercially reasonable efforts" to maintain payroll.

a. Why did the agencies remove the original attestation requirement?

The agencies revised the language regarding "reasonable efforts" to remove ambiguity and clarify that such efforts should be commercially reasonable—that is, that such efforts should be within the range that contribute to the health of the business and its ability to support employment over the longer term. More precisely, the goal of the program is to support the health of businesses through this difficult period so they are able to contribute to a robust economic recovery. Employees are critical contributors to the success of a business, and commercially reasonable efforts to maintain employment contribute to a faster recovery and to the health of a business in the long run.

Commission Discussion:

The agencies have provided a helpful response explaining why they changed "reasonable efforts" to "commercially reasonable efforts." While the Commission does not have a consensus view on the sufficiency of this requirement, we do agree that businesses receiving Main Street loans should faithfully adhere to their loan obligations, including making commercially reasonable efforts to maintain payroll and retain employees while their Main Street loans are outstanding.

b. How do the agencies define "commercially reasonable efforts"?

"Commercially reasonable efforts" is a standard defined in contract law. The application of such a standard in this context means that businesses that participate in the program are expected to make good-faith efforts to maintain payroll and retain employees in light of their respective capacities, economic environment, available resources, and business need for labor.

Commission Discussion:

The Commission appreciate the agencies' clarification of their definition of "commercially reasonable efforts." As the agencies know, the Federal Reserve Bank of Boston has included this same definition in its Frequently Asked Questions document for the Main Street Program.[115] The agencies should act diligently to make sure that borrowers from the Main Street Program are appropriately notified of this definition.

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[115] Federal Reserve Bank of Boston, *Main Street Lending Program Frequently Asked Questions*, June 8, 2020, https://www.bostonfed.org/-/media/Documents/special-lending-facilities/mslp/legal/frequently-asked-questions-faqs.pdf?la=en.

c. How will the agencies enforce this requirement?

The program expects borrowers to make commercially reasonable efforts to maintain payrolls. Such efforts may take different forms across the broad range of businesses eligible for the program. Because of the variety of approaches we expect from borrowers, the agencies will monitor the program's impact on the economic recovery and employment broadly rather than on a borrower-by-borrower basis. We expect to make adjustments to the Main Street Lending Program as needed to ensure the program contributes to robust economic recovery and employment gains.

Commission Discussion:

The agencies' response indicates that they do not intend to monitor, on a borrower-by-borrower basis, whether companies are making "commercially reasonable efforts" to maintain payroll. If that is the case, the agencies should elaborate on how "monitor[ing] the program's impact on the economic recovery and employment broadly" relates to the borrower's obligation to satisfy the loan's payroll term.

D. Municipal Lending Facility

1. How did the agencies decide which municipalities to include in this facility?

The agencies determined eligibility criteria for the MLF with the aim of providing access to credit through the facility to as many municipalities as possible in the shortest timeframe possible. The municipal securities market involves upwards of 50,000 individual issuers, and it would not be logistically feasible for the MLF to stand ready to quickly undertake the diligence reviews and otherwise work with borrowers in order to directly purchase notes from all municipal issuers. Initial direct eligibility was therefore limited to U.S. states and a number of large jurisdictions, while smaller jurisdictions were made eligible to issue notes to the MLF indirectly through another eligible state or municipality.

The agencies have subsequently expanded the facility to include multi-state entities, revenue bond issuers, and a broader range of municipalities, in response to feedback identifying legal barriers that would frustrate indirect participation by previously ineligible entities. The agencies also have amended the terms of the MLF to allow more than one issuer per eligible state, city, or county in order to facilitate the provision of assistance to smaller political subdivisions or other government entities. The MLF continues to encourage large eligible issuers to permit indirect participation by their political subdivisions or other governmental entities, however, because it remains logistically infeasible for the Federal Reserve to purchase notes directly from all U.S. municipalities for the reasons described above.

Commission Discussion:

The agencies have provided a helpful response as to how they decided which municipalities to include in the MLF. The MLF only recently started to operate. As its operations progress the agencies should closely monitor whether there are additional modifications that feasibly could be made to the facility that would help the MLF achieve its purpose.

2. What is the rationale for the population-size criteria that determine the cities and counties eligible for this facility? What are the concerns, if any, about purchasing notes from cities or counties smaller than the thresholds established?

As described above, the population-size criteria for the MLF were selected to enable that the limited number of feasible issuers be allocated to entities serving the greatest number of people in the shortest timeframe possible. It would not be logistically feasible to purchase notes directly from all U.S. cities and counties, and smaller cities and counties have therefore been limited to indirect participation in the MLF through their respective states. Further, all cities and counties—even those ineligible to directly participate in the facility—have benefited from improving market conditions that have resulted from the presence of the MLF as a backstop to the short-term municipal securities market. By addressing the liquidity needs of larger cities and counties, the MLF frees up credit from private market sources to address the needs of smaller cities and counties. This is already evidenced by the significant increase in bank lending agreements that have been filed with EMMA, the Municipal Securities Rulemaking Board's online disclosure portal, since early April.

Commission Discussion:

The agencies have provided a helpful response explaining their rationale for the population-size eligibility criteria for participation in the MLF. We acknowledge that the agencies have given smaller cities and counties the opportunity to indirectly participate in the MLF through their respective states. We also recognize that they have already shown a willingness to modify the population-size eligibility criteria in response to public feedback. The MLF only recently started to operate. As its operations progress, the agencies should closely monitor whether there are additional modifications that could help the MLF achieve its purpose.

3. Why were U.S. territories excluded from this facility?

The MLF is open only to entities that were rated investment grade as of the facility's announcement to ensure compliance with provisions of the Federal Reserve Act, the Board's Regulation A, and the CARES Act. For example, under the Federal Reserve Act, FRBNY must assign a lendable value, consistent with sound risk management practices, to all collateral for a loan extended under section 13(3). The security for any loan under the MLF also must protect the taxpayer from losses. Both requirements are furthered by lending only to investment grade borrowers. The CARES Act also provides that the principal amount of any obligation issued

by a State or municipality under a facility authorized by section 4003(b) of the Act shall not be reduced through loan forgiveness. This provision substantially restricts the MLF's ability to work out or resolve defaulting notes or other obligations that it has purchased. Restricting access to investment-grade issuers furthers compliance with this restriction by reducing the likelihood that the facility will hold debt that falls into default. Moreover, given the large number and heterogeneous nature of issuers of municipal debt, it can be difficult to assess and compare their creditworthiness. Credit ratings provide an objective, transparent, and efficient means by which the agencies can assess the risk associated with lending to an issuer.

No U.S. territory is rated investment grade. Given their financial circumstances, additional debt that cannot be forgiven is unlikely to provide U.S. territories with substantial relief. Further, Puerto Rico is in default on its general obligation debt and would therefore be prohibited from accessing the Facility by the Board's Regulation A. Puerto Rico is the only U.S. territory with independent local governments, and the Federal Reserve is not aware of any local Puerto Rican government that carries an investment-grade rating. After Hurricanes Irma and Maria, the U.S. Virgin Islands and its power authority borrowed approximately $300 million from Federal Emergency Management Agency ("FEMA") through its Community Disaster Loan Program and have already sought loan forgiveness for such loans from FEMA because of their limited debt repayment capacity.

Commission Discussion:

The agencies have provided a helpful response explaining why U.S. territories are not currently eligible for the MLF, namely because they are not investment grade. The Commission requests that the agencies weigh the costs and benefits for treating territories the same as similarly situated state and local borrowers. The MLF only recently started to operate. As its operations progress, the agencies should closely monitor whether there are additional modifications that feasibly could be made, if prudent, to the MLF's eligibility requirements to enable U.S. territories to participate in the facility consistent with the requirements of the Federal Reserve Act, the Federal Reserve's Regulation A, and the CARES Act.

APPENDIX A

May 29, 2020

The Honorable Steven T. Mnuchin
Secretary
U.S. Department of the Treasury
1500 Pennsylvania Avenue, NW
Washington, D.C. 20220

The Honorable Jerome H. Powell
Chairman
Board of Governors of the Federal Reserve
20th Street and Constitution Avenue, NW
Washington, D.C. 20551

Dear Secretary Mnuchin and Chairman Powell:

We write as members of the Congressional Oversight Commission (the "Commission") created by the CARES Act. The Commission's role is to conduct oversight of the implementation of Division A, Title IV, Subtitle A of the CARES Act ("Subtitle A") by the Treasury Department (the "Treasury") and the Federal Reserve. On May 18, the Commission issued its first report, outlining, among other things, some preliminary questions we have about the actions of the Treasury and the Federal Reserve in implementing Subtitle A so far. The Commission is required by statute to issue a report every thirty days.

As we carry out our responsibilities and prepare for future reports, we request your assistance in two ways. First, we ask that you provide answers to the questions that we posed in our May 18 report. Second, we ask that you meet with us to discuss the Treasury and Federal Reserve's implementation of Subtitle A and that the meeting be held promptly.

We have broken down the questions we asked in our May 18 report into two tiers, which are identified in the appendix to this letter. We request that you provide answers to the tier 1 questions by June 8. We request that you provide answers to the tier 2 questions by June 29. We look forward to receiving your answers in writing or through conversations with our staff.

Thank you for your attention to this matter.

Sincerely,

/s/
French Hill
Member of Congress

/s/
Bharat Ramamurti
Commissioner

/s/
Donna E. Shalala
Member of Congress

/s/
Pat Toomey
U.S. Senator

Enclosure: Appendix

APPENDIX

TIER 1 QUESTIONS

I. General Questions

1. How will the Treasury and the Fed (the “agencies”) assess the success or failure of this program?

2. The agencies are supposed to use this program to stabilize the economy and help companies and municipalities with liquidity issues stemming from the COVID-19 crisis. How will the agencies attempt to achieve this goal while protecting taxpayer dollars? Are the agencies prepared to lose taxpayer dollars in an effort to facilitate more lending and support to a broader set of entities?

II. Program and Facility-Specific Questions

Primary Market Corporate Credit Facility (PMCCF)

1. How did the agencies determine the eligible assets for purchase by this facility?

2. Why did the agencies require an issuer to be rated investment grade by the credit rating agencies as of March 22, 2020 to be an eligible issuer for this facility? What would be the implications of broadening eligibility to this facility to issuers rated non-investment grade?

3. Why did the agencies choose March 22, 2020 as the cutoff date for an issuer to be rated investment grade to be an eligible issuer for this facility? How will this date selection impact the ability of issuers that have been downgraded from investment grade to non-investment grade to access capital through this facility?

4. Why did the agencies limit eligible issuers to those rated by a major nationally recognized statistical rating organization (NRSRO) as opposed to issuers rated by other credit rating organizations?

Secondary Market Corporate Credit Facility (SMCCF)

1. Is there a concern that changes in secondary market bond prices will reduce the flow of credit to households and businesses or create risk to the financial system? If so, how and what is the strategy for using this facility to address that concern?

2. On May 4, the Federal Reserve Bank of New York announced that it plans to use this facility to purchase Exchange Traded Funds (ETFs) that may own bonds rated below investment grade. How did the Fed reach this decision, and how does it measure the trade-offs of purchasing such ETFs?

3. The Fed has hired the firm Blackrock to serve as an investment manager for this facility. How is the Fed ensuring Blackrock is acting in the best interest of the Fed and the public?[1]

4. Does Blackrock have a duty of best execution to the Fed?

5. BlackRock has entered into a contract with the New York Federal Reserve Bank to provide management and advisory services to the facility. In that role, BlackRock employees will have access to material non-public information. Per the contract, certain BlackRock executives with access to that information will have the ability to provide "investment management, trading, and/or advisory services to other clients with respect to securities other than corporate bonds, ETFs, equity securities, or derivatives the value of which are tied to such instruments, including providing general market views and market views related to securities other than corporate bonds, ETFs, equity securities, or derivatives the value of which are tied to such instruments." They are also permitted to provide "investment management, trading or advisory services" in any asset class and to purchase investments for themselves in any asset class after a two-week cooling-off period.

    a. Why is two weeks an appropriate cooling-off period?

    b. How will any breaches of the non-public information be reported? What will be the discipline for such breaches?

Main Street Lending Program

1. Why did the agencies choose the 85% and 95% purchase rates for the SPVs in this program?

2. Why did the agencies choose the employee-size and annual revenue criteria that determine which businesses are eligible for this program?

3. How did the agencies choose the minimum loan sizes for the facilities in this program?

4. Why did the agencies decide not to create the mid-sized business lending facility that is described but not mandated in Section 4003(c)(3)(D) of the CARES Act?

5. What is the agencies' rationale for the adjusted earnings before interest, taxes, depreciation, and amortization (EBITDA) and leverage standards for loans in this program?

6. Between the initial announcement of the Main Street facilities on April 9 and the modifications to the facilities the Fed announced on April 30, the Fed reportedly received more than 2,200 comments from experts, industry groups, and others. Will the Fed release those comments so the public can review them?

[1] This question about BlackRock was in the Commission's May 18 report. However, the two questions about BlackRock that follow (questions #4 and #5) were not.

7. As part of its April 30 revisions to the facility term sheets for this program, the agencies removed the requirement that companies attest that they require financing "due to the exigent circumstances presented by the coronavirus disease."

    a. Why did the agencies remove that requirement?

    b. Without this requirement, how will the agencies ensure they are providing liquidity "to eligible businesses, [s]tates, and municipalities *related to losses incurred as a result of coronavirus*"?

8. As part of its April 30 revisions to the facility term sheets for this program, the agencies eliminated the requirement that firms attest to making "reasonable efforts" to maintain payroll and retain employees during the term of the loan and replaced it with a requirement that firms should make "commercially reasonable efforts" to maintain payroll.

    a. Why did the agencies remove the original attestation requirement?

    b. How do the agencies define "commercially reasonable efforts"?

    c. How will the agencies enforce this requirement?

Municipal Lending Facility

1. How did the agencies decide which municipalities to include in this facility?

2. What is the rationale for the population-size criteria that determine the cities and counties eligible for this facility? What are the concerns, if any, about purchasing notes from cities or counties smaller than the thresholds established?

3. Why were U.S. territories excluded from this facility?

TIER 2 QUESTIONS

I. General Questions

1. If the agencies use economy-wide metrics, like GDP growth, unemployment rates, or wage growth, to assess the success or failure of this program how will they isolate the effects of this program from other factors, including other federal and state relief measures?

2. If the agencies use more narrow metrics, like bond spreads, to assess the success or failure of this program how will they assess how changes in those metrics affect the broader economy, including the financial well-being of the people of the United States?

3. Do the agencies believe the Fed's emergency lending programs are better suited to assist bigger companies that can access the capital markets than smaller firms that cannot? If not, why not? If so, what are the agencies doing to counteract that issue?

4. Will the agencies faithfully follow the statutory requirements of Subtitle A when implementing the lending programs and facilities?

5. How can the agencies best determine the lending capacity of, and Treasury investment into, each Fed lending facility under Subtitle A in order to help support and stabilize the economy?

6. How can the agencies best determine how much of the Treasury's $454 billion in CARES Act funds to allocate among Fed lending facilities and when to allocate such funds in order to help support and stabilize the economy?

7. How can the agencies best estimate the risk of loss to taxpayer funds in each Fed lending facility?

8. How will the Fed ensure it complies with all restrictions to emergency lending under Section 13(3) of the Federal Reserve Act, including those prohibiting lending to insolvent borrowers?

9. How can the agencies best monitor compliance with and enforce the conflict of interest rules governing the agencies' lending programs and facilities?

10. How can the agencies best enforce the statutory terms and conditions for borrowers under their lending programs and facilities under Subtitle A, including the condition that borrowers are U.S. businesses, as defined by the CARES Act?

11. How will loans under these programs and facilities comply with Bank Secrecy Act (BSA) and the Anti-Money Laundering (AML) rules?

12. How will the agencies decide when to hire third parties to help manage the program or specific facilities? How will the agencies mitigate conflicts of interest these third parties might have?

13. Regarding outside services to assist the agencies to manage the programs and facilities, what is the competitive selection process for custody and fund management services? How are conflicts of interest mitigated?

14. The agencies' emergency lending programs and facilities provide lending directly through government loans and indirectly through banks and other qualified lenders. What are the trade-offs involved with these different delivery mechanisms?

15. While quickly providing lending to borrowers may result in more fraud and abuse, it may also assist many eligible borrowers that need money quickly. How should the agencies balance these trade-offs?

16. The Congressional Budget Office (CBO) recently published its preliminary estimate of the budgetary effects of the CARES Act. CBO's estimate concludes that "the income and the costs stemming from" the Fed's emergency lending facilities funded by the CARES Act "are expected to roughly offset each other." CBO notes that the Fed did "not sustain losses on similar lending . . . [d]uring the financial crisis of 2008 and 2009."[2] Do you believe CBO is correct in its assumptions of a no net cost result? In order to accomplish the goal of economic stabilization and return to economic growth, is this a reasonable assumption?

17. How can the agencies best incentivize private-sector financial institutions to help facilitate the Treasury and the Fed's lending programs and facilities to ensure credit gets to American households and businesses, while ensuring that taxpayer dollars are well spent?

18. How can the agencies best set rates and fees for the Treasury and the Fed's lending programs and facilities under Subtitle A to ensure their workability and that the federal government remains the lender of last resort?

19. What will the effect of Treasury and Fed lending be on overall employment?

20. Do the agencies believe it is appropriate to modify the facilities to ensure specific companies or industries have access to some or all of the funds? If so, how are those modifications being considered in a manner that also addresses all industries and sectors?

II. Program and Facility-Specific Questions

Primary Market Corporate Credit Facility (PMCCF)

1. Through this facility, the Fed, through an SPV, will be purchasing new bonds from companies. Do the agencies intend to place limitations or parameters around companies receiving this support, or use of proceeds? Are such limitations workable in capital markets transactions? Do the agencies believe the proceeds of bond purchases will help stabilize the economy regardless of how the proceeds are used?

2. The Federal Reserve Bank of New York, which is implementing this facility, recently stated that a U.S. subsidiary of a foreign company can qualify for support through the facility. How does the Federal Reserve Bank of New York plan on enforcing its requirement that proceeds derived from participation in the facility may only be used for the benefit of the U.S. subsidiary issuer, its consolidated U.S. subsidiaries, and affiliates of the U.S. subsidiary issuer that are U.S. businesses, rather than for the benefit of its foreign affiliates?

Main Street Lending Program

1. Do the agencies plan to expand eligible lenders in this program beyond depository institutions? Why or why not?

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[2] Letter from Phillip L. Swagel, Director, Congressional Budget Office to U.S. Senator Mike Enzi, Apr. 27, 2020, https://www.cbo.gov/system/files/2020-04/hr748.pdf.

Municipal Lending Facility

1. What conditions, if any, including those related to policies, will the agencies impose on states and municipalities that receive funding under this facility?

2. What is the rationale for the three-year repayment terms under this facility?

3. Will the agencies disclose information about any states, counties, and cities whose applications for loans from this facility are denied?

Loans for the Airline Industry and National Security Businesses Under Subtitle A

1. How many applications has the Treasury received for loans under Subtitle A?

2. How is the Treasury measuring and evaluating any proposals that loan applicants submit "on the form and amount of taxpayer protections they propose to provide" as part of their loan agreements, such as a warrant or equity instrument in an applicant's business?

3. When does the Treasury anticipate approving and disbursing these loans?

4. Under Subtitle A, the Treasury's loan agreements with the airline industry and businesses critical to maintaining national security must require a borrower to "not reduce its employment levels by more than 10 percent from the levels" as of March 24, 2020. How does Treasury intend to faithfully apply this statutory requirement?

APPENDIX B

June 8, 2020

The Honorable French Hill
U.S. House of Representatives
Washington, DC 20515

The Honorable Donna E. Shalala
U.S. House of Representatives
Washington, DC 20515

Mr. Bharat Ramamurti
Commissioner
Washington, DC 20515

The Honorable Pat Toomey
United States Senate
Washington, DC 20510

Dear Members of the Congressional Oversight Commission:

Thank you for your letter dated May 29, 2020, regarding the actions of the Department of the Treasury and the Board of Governors of the Federal Reserve System under Division A, Title IV, Subtitle A of the CARES Act. We look forward to working with the Commission to ensure that implementation of the CARES Act is carried out consistent with the statute's text and purpose.

Please find attached answers to the Tier 1 questions posed by the Commission in your correspondence.

Sincerely,

Steven T. Mnuchin
Secretary
U.S. Department of the Treasury

Jerome H. Powell
Chair
Board of Governors of the Federal Reserve System

Enclosure

Congressional Oversight Commission: Answers to Tier 1 Questions

I. General Questions

1. *How will Treasury and the Fed ("the agencies") assess the success or failure of this program?*

The Board of Governors of the Federal Reserve System (the "Board"; together with the Federal Reserve Banks, the "Federal Reserve") with the support and approval of the Department of the Treasury ("Treasury"; together with the Federal Reserve, the "agencies") has established a set of lending facilities pursuant to the Coronavirus Aid, Relief, and Economic Security Act ("CARES Act") and under section 13(3) of the Federal Reserve Act (the "13(3) facilities"). The agencies created the 13(3) facilities in response to the unprecedented financial and economic strains imposed by the COVID-19 pandemic and by the public health measures employed in response. The agencies monitor a broad range of economic and financial indicators to judge economic activity, credit flows, and market functioning as a whole. The Federal Reserve designed the facilities to work together to protect financial stability and support achievement of its dual mandate of full employment and price stability.

Broadly speaking, the 13(3) facilities established with the support and approval of Treasury using funds made available by the CARES Act—the corporate credit facilities (the Primary Market Corporate Credit Facility ("PMCCF") and Secondary Market Corporate Credit Facility ("SMCCF")), the Main Street Lending Program (the Main Street New Loan Facility ("MSNLF"); the Main Street Priority Loan Facility ("MSPLF"); and the Main Street Expanded Loan Facility ("MSELF")); the Term Asset-Backed Securities Loan Facility ("TALF"); and the Municipal Liquidity Facility ("MLF")—have as their immediate goal the promotion of the flow of credit to businesses, households and state and local governments. The effectiveness of all these facilities is generally best measured by the degree to which the targeted market or area of the economy recovers by having the program present.

As noted, the agencies monitor a variety of indicators to assess the performance of the 13(3) facilities. With respect to short-term funding markets, among other indicators, we monitor issuance, maturity, outstandings and spreads for a range of money market instruments, including repurchase agreements, commercial paper, certificates of deposit, and variable-rate demand notes. We also measure pressures on key institutions and intermediaries in these markets, which include, but are not limited to, money market funds, commercial banks and dealers. Finally, we monitor the volume and key features of assets pledged to, or purchased by, these facilities as well as the counterparties to these transactions.

When judging the flow of credit to households, businesses, and state and local governments, we use similar metrics. Among these, we monitor the issuance, maturity, outstandings, and spreads for a wide range of debt instruments, including auto, credit card, and other consumer loans; loans to small businesses; syndicated loans; corporate bonds; municipal notes and bonds; and asset-backed securities. We also monitor measures of market functioning, such as bid-ask spreads, trading costs, order book depth, trading volumes, and price volatility. Moreover, the agencies monitor the health of key institutions and intermediaries in these credit markets, which include, but are not limited to, open-end mutual funds, commercial banks, and dealers. Finally,

as these facilities come to operational readiness, we monitor the volume and key characteristics of loans made (or assets purchased) by these facilities, as well as the set of businesses and governmental entities (e.g., states and municipalities) using the facilities.

2. *The agencies are supposed to use this program to stabilize the economy and help companies and municipalities with liquidity issues stemming from the COVID-19 crisis. How will the agencies attempt to achieve this goal while protecting taxpayer dollars? Are the agencies prepared to lose taxpayer dollars in an effort to facilitate more lending and support to a broader set of entities?*

In implementing the 13(3) facilities using the authority provided by the CARES Act, and under the Federal Reserve Act, the agencies are committed to addressing the severe economic dislocations that have occurred as a result of the impact of COVID-19. We have designed the 13(3) facilities to provide liquidity to solvent borrowers—businesses and states and municipalities—to better enable these organizations to either rehire their workers when the economy reopens or keep them on board. Consistent with the CARES Act, these facilities also are designed and implemented in compliance with section 13(3) of the Federal Reserve Act, which provides that the Federal Reserve is restricted to making loans that are secured to the satisfaction of the lending Reserve Bank and that carry sufficient credit protections to protect taxpayers from losses. Equity investments provided by Treasury, including equity investments made by Treasury using funds appropriated by Congress under the CARES Act, are designed to cover losses on loans made by the facility, including in downside economic scenarios—and thus inherently may take loss. Treasury accepts the possibility that losses may occur with respect to the funds it has committed, and believes that the terms and conditions of the 13(3) programs to which it has committed funds appropriately balance the interests of taxpayer protection and program efficacy.

We have focused to date on the most pressing needs for liquidity support in the U.S. economy. We are willing to adapt and extend these programs—or adopt additional programs—if appropriate to address the economy's evolving needs or our evolving understanding of its needs. The Federal Reserve expects that its loans made to fund the 13(3) facilities will be fully repaid under a very broad range of economic outcomes. The performance of Treasury equity investment in the 13(3) facilities will depend on program features and future economic conditions.

II. Program and Facility-Specific Questions

Primary Market Corporate Credit Facility (PMCCF)

1. *How did the agencies determine the eligible assets for purchase by this facility?*

Under the PMCCF term sheet, there are two groups of eligible assets. First, the PMCCF may purchase eligible corporate bonds as the sole investor in a bond issuance. Second, the PMCCF may purchase portions of syndicated loans or bond issuances of eligible issuers at

issuance; the PMCCF may purchase no more than 25 percent of any such loan syndication or bond issuance.

The agencies established the PMCCF to ensure that creditworthy companies that rely on capital markets to fund their operations have access to credit during the current unusual and exigent circumstances in which financial markets are experiencing extraordinary disruptions, volatility, and illiquidity. Corporate bonds support the operations of companies with more than 17 million employees based in the United States, and these bonds are key investment assets for retirees and pension funds. If companies are unable to issue corporate bonds, they may be unable to invest in inventory and equipment, meet current liabilities, or pay employees. The PMCCF seeks to ensure that creditworthy companies with maturing capital markets instruments (namely, syndicated loans and corporate bonds) retain the ability to refinance debt as well as access additional credit to ensure liquidity through this unprecedented period of COVID-19-related disruption.

Since the PMCCF's goal is to provide general support to creditworthy companies, and not to select among different industries and companies, the PMCCF utilizes a broad, transparent and simple ratings-based eligibility standard. In addition, since depository institutions and depository institution holding companies have access to other sources of support, their debt instruments are excluded from eligibility, as are companies that received specific lending support from Treasury under the CARES Act. Finally, because the equity provided to the PMCCF by the Treasury includes funds appropriated under the CARES Act, companies that participate in the PMCCF must comply with the U.S. business, conflict company, and other applicable CARES Act requirements.

2. *Why did the agencies require an issuer to be rated investment grade by the credit rating agencies as of March 22, 2020, to be an eligible issuer for this facility? What would be the implications of broadening eligibility to this facility to issuers rated non-investment grade?*

The PMCCF seeks to support creditworthy companies that rely on capital markets to fund their operations during unusual and exigent circumstances. Section 13(3) of the Federal Reserve Act and the Board's Regulation A require that a lending Reserve Bank secure itself to its satisfaction and ensure protection of the taxpayer. A historical investment-grade rating reflects positively on the creditworthiness of a firm prior to the unprecedented period of COVID-19-related disruption. Issuers that are rated investment grade have historically realized default rates that are significantly lower than issuers rated non-investment grade. Therefore, acquiring capital markets instruments of investment-grade issuers provides greater security than acquiring capital markets instruments of non-investment-grade issuers.

If the eligibility criteria of the PMCCF were broadened to include issuers that were not rated investment grade as of March 22, 2020, the number of companies eligible to obtain credit from the PMCCF would increase. Such an expansion, however, would increase the credit risk to the PMCCF at a rate greater than the proportionate increase in potential borrowers, due to the higher leverage and default risk of high-yield borrowers.

3. *Why did the agencies choose March 22, 2020, as the cutoff date for an issuer to be rated investment grade to be an eligible issuer for this facility? How will this date selection impact the ability of issuers that have been downgraded from investment grade to non-investment grade to access capital through this facility?*

The two corporate credit facilities were initially authorized by the Board and approved by the Secretary of the Treasury on March 22, 2020. That cut-off date was chosen for the ratings criteria in order to extend the reach of the facilities to include all companies eligible at the announcement date, regardless of how long it would take to operationalize the facilities.

Issuers that were investment grade prior to March 22, 2020, but were subsequently downgraded, may still be eligible to access the PMCCF. They must be rated at least BB-/Ba3 as of the date on which the PMCCF makes a purchase. If rated by multiple major NRSROs, such issuers must be rated at least BB-/Ba3 by two or more NRSROs at the time the PMCCF makes a purchase.

4. *Why did the agencies limit eligible issuers to those rated by a major nationally recognized statistical rating organization (NRSRO) as opposed to issuers rated by other credit rating organizations?*

The PMCCF uses ratings to evaluate the credit quality of companies in order to determine whether they may access the facility. To enable a quick launch, the PMCCF originally relied on the three NRSROs that the largest number of investors rely on. After conducting additional analysis, the facility recently added another three rating agencies to the list of eligible NRSROs. In assessing which rating agencies to deem eligible, the agencies analyzed a wide range of factors, including the extent to which an individual rating agency is relied upon by private-sector investors with respect to the relevant asset classes.

Secondary Market Corporate Credit Facility (SMCCF)

1. *Is there a concern that changes in secondary market bond prices will reduce the flow of credit to households and businesses or create risk to the financial system? If so, how and what is the strategy for using this facility to address that concern?*

Since the onset of the COVID-19 pandemic, the corporate bond market has experienced significant dislocations. By facilitating market functioning, the SMCCF is intended to reduce the risk that secondary market prices for corporate bonds become subject to fire sales or price dislocations. These price dislocations are important because they affect the primary markets for American companies to access capital. Potential buyers may purchase bonds sold at distressed prices in the secondary market rather than buying newly issued bonds directly from companies, reducing the availability of new credit to fund companies. By providing support to the secondary market, the SMCCF reduces the cost of credit and increases the availability of credit to borrowers who might otherwise not be able to access the market with new corporate bond issuances at reasonable rates. In addition, there is a direct relationship between the secondary market and the primary market, as most new corporate bond prices are set based on secondary market spreads.

2. *On May 4, the Federal Reserve Bank of New York announced that it plans to use this facility to purchase exchange-traded funds (ETFs) that may own bonds rated below investment grade. How did the Fed reach this decision and how does it measure the trade-offs of purchasing such ETFs?*

Market functioning in the corporate credit market has been impaired based on metrics such as prices, bid ask spreads, trading volumes, and price volatility as well as limited primary market issuance from high-yield issuers. By purchasing ETFs that have exposure to high-yield issuers, the SMCCF seeks to provide support to the more dislocated segments of the corporate bond market and to limit discontinuities between the different segments of the market. Such discontinuities can lead to extreme outcomes where companies downgraded a single notch—from low investment-grade to the upper end of high-yield—find themselves facing sharply higher funding costs and thus are under increased pressure to cut costs, including by reducing their workforces. The increased risk associated with acquiring instruments issued by high-yield companies is managed by investing through instruments that allow for the creation of a diversified portfolio and by the increased amount of Treasury's equity allocated to support these purchases. The agencies also limit the amount of risk to the SMCCF from purchases of high-yield ETFs by ensuring that the large majority of ETF purchases target the investment-grade corporate bond market.

3. *The Fed has hired the firm Blackrock to serve as an investment manager for this facility. How is the Fed ensuring Blackrock is acting in the best interest of the Fed and the public?*

On May 11, 2020, Corporate Credit Facilities LLC ("CCF"), a special purpose vehicle created to facilitate the operations of SMCCF, entered into an Investment Management Agreement ("IMA") with BlackRock Financial Management, Inc. ("BlackRock"). The Federal Reserve Bank of New York ("FRBNY") is the sole managing member of the CCF.

Pursuant to the IMA, BlackRock acts as a fiduciary to the CCF in performing investment management services. In order to best advance the CCF's objectives as a fiduciary, BlackRock is required to follow FRBNY's specific and detailed investment guidelines and to buy and sell corporate bonds, corporate loans, and corporate bond ETFs on a best execution basis. BlackRock is required to communicate with the CCF on a daily basis regarding its planned purchase activity for the day and respond to requests for updates from the CCF on market functioning and asset purchases.

The IMA imposes stringent requirements on BlackRock to protect confidential information and to mitigate conflicts of interest. Confidential information gained by BlackRock or its affiliates or their respective directors, officers, or employees in the course of this engagement may not be leveraged for matters unrelated to the CCF. BlackRock's compliance with the rigorous information barrier and conflict of interest mitigation provisions the Federal Reserve has imposed under the IMA is subject to audit and review by FRBNY, the Board, and other governmental authorities with oversight responsibilities under applicable law.

These are select examples of provisions relating to the Federal Reserve's efforts to ensure that Blackrock is acting in the best interest of the public. The IMA, including the investment guidelines, is available in full on the FRBNY website. *See* https://www.newyorkfed.org/medialibrary/media/markets/SMCCF_Investment_Management_Agreement.pdf.

4. *Does Blackrock have a duty of best execution to the Fed?*

Yes. The Operating Guidelines set out in the IMA provide that "[a]ll transactions in Eligible ETFs will be effected through Eligible Sellers at market prices on a best execution basis in accordance with [the IMA], whether in the secondary market or via primary creations and redemptions."

5. *BlackRock has entered into a contract with the New York Federal Reserve Bank to provide management and advisory services to the facility. In that role, BlackRock employees will have access to material non-public information. Per the contract, certain BlackRock executives with access to that information will have the ability to provide "investment management, trading, and/or advisory services to other clients with respect to securities other than corporate bonds, ETFs, equity securities, or derivatives the value of which are tied to such instruments, including providing general market views and market views related to securities other than corporate bonds, ETFs, equity securities, or derivatives the value of which are tied to such instruments." They are also permitted to provide "investment management, trading or advisory services" in any asset class and to purchase investments for themselves in any asset class after a two-week cooling-off period.*

a. *Why is two weeks an appropriate cooling-off period?*

b. *How will any breaches of the non-public information be reported? What will be the discipline for such breaches?*

The IMA provides stringent requirements to protect confidential information and to mitigate conflicts of interest. Confidential information gained by BlackRock or its affiliates or their respective directors, officers, or employees in the course of this engagement may not be leveraged for matters unrelated to the CCF. This restriction prohibits, without limitation, use of any confidential information for the benefit of BlackRock, for the benefit of any other BlackRock client, or to inform any financial transaction, render any advice or recommendation, or attempt to influence any market or transaction for the benefit of any individual or entity other than the CCF. This obligation survives the termination or expiration of the IMA.

The "two-week cooling off period" relates to the information wall between BlackRock employees who are involved in providing investment management, trading, and/or advisory services to the CCF or FRBNY and other BlackRock employees. BlackRock employees providing such services to the CCF or FRBNY—for the duration of when they have access to material nonpublic information plus a two week cooling off period—are prohibited from providing investment management, trading, or advisory services to anyone other than the CCF in any of the asset classes held by BlackRock and must also refrain from purchasing for him/herself

investments in any of the asset classes held by BlackRock, unless authorized by the Chief Compliance Officer of FRBNY. The two-week period is intended to ensure that material nonpublic information loses its value in the market. To be clear, even after the two-week cooling off period, material nonpublic information may not be leveraged for matters unrelated to the CCF. Additional information is available in Exhibit G to the IMA, which sets forth the Information Barrier and Conflicts of Interest Mitigation Procedures. *See* https://www.newyorkfed.org/medialibrary/media/markets/SMCCF_Investment_Management_Agreement.pdf.

The IMA requires that breaches of confidential information be reported promptly. Should a breach occur, FRBNY will respond with diligence and promptness. Consequences for any breach will be determined by the Federal Reserve.

Main Street Lending Program

1. *Why did the agencies choose the 85% and 95% purchase rates for the SPVs in this program?*

The Main Street SPV will purchase participations in MSNLF loans, MSPLF loans, and MSELF upsized tranches. The agencies considered several factors in sizing participations in Main Street eligible loans and upsized tranches. The agencies created Main Street facilities that purchase sizable (but less than 100 percent) participations in loans in order to maintain a level of risk sharing that limits downside risk and creates balance sheet capacity for eligible lenders, while at the same time ensuring eligible lenders have a strong incentive to apply prudent underwriting and risk management standards. Upon full consideration of the relevant factors, the agencies believe that a 95 percent participation provides an appropriate balance of these considerations for all three Main Street facilities. Accordingly, on June 8 the Board issued revised term sheets that, among other changes, specify a 95% participation percentage for MSPLF loans (up from 85%), while maintaining the 95% participation percentage for MSNLF and MSELF loans.

2. *Why did the agencies choose the employee-size and annual revenue criteria that determine which businesses are eligible for this program?*

Employee size and annual revenue criteria are used for the Small Business Administration's (SBA) 7(a) program and Payroll Protection Program ("PPP") and are commonly used to measure the footprint of a business. The adoption of such metrics was considered prudent, because the program is designed to support small and medium-sized businesses that are unable to receive sufficient assistance through other programs, such as the SBA's PPP, and that lack access to the Federal Reserve's Primary and Secondary Market Corporate Credit Facilities. The agencies set the employee and revenue criteria for the Main Street Lending Program to provide broad access to companies that lack access to or sufficient support from other existing programs and were otherwise in sound financial condition prior to the crisis.

The agencies have not set a lower bound "floor" for borrower size under the program, thereby providing access to small businesses that met other program criteria. The upper bounds for the employee-size and annual revenue criteria were raised from 10,000 employees or $2.5

billion in revenues to 15,000 employees or $5 billion in revenues in response to public feedback that the lower levels initially proposed would have scoped out businesses that could benefit from Main Street loans. The changes were also intended to provide a better congruence with the PMCCF and SMCCF by capturing a wider swath of companies that may not have reached the scale needed to issue the kinds of capital market instruments that would be purchased under the PMCCF and SMCCF.

3. *How did the agencies choose the minimum loan sizes for the facilities in this program?*

The agencies considered several factors in determining minimum loan sizes. Consistent with the desire to assist companies that may have received insufficient support through the PPP or that are unable to receive support through the PMCCF or SMCCF, the Main Street Lending Program targeted a minimum loan size that would be attractive to a broad range of small and medium-sized businesses that may not have been able to receive support from these other programs. The agencies also had a desire to maintain sufficient overlap with the upper bound of the PPP in order to avoid excluding inadvertently a set of businesses from assistance. The agencies considered public feedback received and, in the revised term sheets issued on June 8, have selected $250,000 (lowered from $500,000) as the minimum loan size for the MSNLF and MSPLF in an effort to make the Main Street Lending Program accessible to as many borrowers as possible, while ensuring the program is feasible from an operational perspective.

The minimum loan size of the MSELF, at $10 million, was set significantly higher than that of the MSNLF or MSPLF because MSELF upsized tranches are likely more attractive to larger, more sophisticated borrowers with more complex funding structures.

4. *Why did the agencies decide not to create the mid-sized business lending facility that is described but not mandated in Section 4003(c)(3)(D) of the CARES Act?*

The agencies designed the Main Street Lending Program to meet the needs of small and medium-sized businesses as effectively and efficiently as possible, while protecting taxpayer funds. The program is designed within the parameters of Section 13(3) of the Federal Reserve Act, the CARES Act, and the Board's Regulation A, and includes CARES Act restrictions on executive compensation, capital distributions, and equity repurchases. The program includes a number of features that are designed to be attractive to small and medium-sized businesses, including deferral of interest payments for one year and deferral of repayment of principal for two years.

5. *What is the agencies' rationale for the adjusted earnings before interest, taxes, depreciation, and amortization (EBITDA) and leverage standards for loans in this program?*

Fundamentally, the agencies decided to use a leverage test based on EBITDA as the key parameter to govern the credit risk assumed by the Main Street Lending Program. The use of EBITDA and leverage requirements is standard industry practice in evaluating a potential borrower's creditworthiness for cash flow-based lending. Lenders and borrowers regularly agree to adjust a borrower's EBITDA to accommodate differences in business models across industries and to accommodate one-time events that may positively or negatively impact a borrower's

earnings. When applied prudently, these adjustments provide a lender with a more accurate representation of a business's earnings capacity over time.

Allowing for leverage of 4x or 6x adjusted EBITDA is within the normal range of practice across the banking industry. The agencies determined that leverage of 4x adjusted EBITDA is reasonable for the MSNLF given the parameters of MSNLF Loans, but they allowed for greater leverage within the MSELF and MSPLF because other risk mitigating features and protections exist in those facilities, such as the additional security required in the MSELF and the larger risk retention requirement in the MSPLF.

6. *Between the initial announcement of the Main Street facilities on April 9 and the modifications to the facilities the Fed announced on April 30, the Fed reportedly received more than 2,200 comments from experts, industry groups, and others. Will the Fed release those comments so the public can review them?*

The agencies received more than 2,200 comments from small and medium-sized business owners, industry groups, nonprofit organizations, and lenders between April 9 and April 30. After reviewing the comments received, the agencies expanded many aspects of the Main Street Lending Program to make credit available to a greater number of small and medium-sized businesses across the country. We are in the process of preparing the comments received for public release by removing certain proprietary commercial and personally identifiable information. We anticipate releasing the comments to the public by the end of the month.

7. *As part of its April 30 revisions to the facility term sheets for this program, the agencies removed the requirement that companies attest that they require financing "due to the exigent circumstances presented by the coronavirus disease."*

a. *Why did the agencies remove that requirement?*

b. *Without this requirement, how will the agencies ensure they are providing liquidity "to eligible businesses, [s]tates, and municipalities related to losses incurred as a result of coronavirus"?*

Nearly all sectors of the U.S. economy have been affected directly or indirectly by the exigent circumstances presented by the coronavirus pandemic. As adopted following the expiration of the public comment period, the Main Street Lending Program includes key features that more directly and effectively target credit to borrowers that have experienced a change in circumstances over the past several months. For example, while an eligible borrower's loans outstanding with the eligible lender must have received an internal risk rating that is equivalent to a "pass" rating used by supervisors, the term sheets intentionally specify that the relevant "as of" date for assignment of that rating is December 31, 2019—a date that precedes the onset of the COVID-19 disruption in the United States. In similar fashion, the mandatory Main Street borrower certification requires borrowers to attest that they (i) had generally been paying their undisputed debts due during the 90 days preceding the Main Street loan (unless the borrower is behind on its obligations because of disruptions to its business caused by the COVID-19 pandemic), and (ii) will be in a position following receipt of the Main Street loan to bring current

any debts that have fallen into arrears during the period of COVID-19 disruption. These program features are designed to make Main Street funding available to businesses that were in sound financial condition prior to the onset of the pandemic, but that may need additional financing to support operations until conditions normalize.

8. *As part of its April 30 revisions to the facility term sheets for this program, the agencies eliminated the requirement that firms attest to making "reasonable efforts" to maintain payroll and retain employees during the term of the loan and replaced it with a requirement that firms should make "commercially reasonable efforts" to maintain payroll.*

a. Why did the agencies remove the original attestation requirement?

The agencies revised the language regarding "reasonable efforts" to remove ambiguity and clarify that such efforts should be commercially reasonable—that is, that such efforts should be within the range that contribute to the health of the business and its ability to support employment over the longer term. More precisely, the goal of the program is to support the health of businesses through this difficult period so they are able to contribute to a robust economic recovery. Employees are critical contributors to the success of a business, and commercially reasonable efforts to maintain employment contribute to a faster recovery and to the health of a business in the long run.

b. How do the agencies define "commercially reasonable efforts"?

"Commercially reasonable efforts" is a standard defined in contract law. The application of such a standard in this context means that businesses that participate in the program are expected to make good-faith efforts to maintain payroll and retain employees in light of their respective capacities, economic environment, available resources, and business need for labor.

c. How will the agencies enforce this requirement?

The program expects borrowers to make commercially reasonable efforts to maintain payrolls. Such efforts may take different forms across the broad range of businesses eligible for the program. Because of the variety of approaches we expect from borrowers, the agencies will monitor the program's impact on the economic recovery and employment broadly rather than on a borrower-by-borrower basis. We expect to make adjustments to the Main Street Lending Program as needed to ensure the program contributes to robust economic recovery and employment gains.

Municipal Lending Facility

1. *How did the agencies decide which municipalities to include in this facility?*

The agencies determined eligibility criteria for the MLF with the aim of providing access to credit through the facility to as many municipalities as possible in the shortest timeframe possible. The municipal securities market involves upwards of 50,000 individual issuers, and it would not be logistically feasible for the MLF to stand ready to quickly undertake the diligence

reviews and otherwise work with borrowers in order to directly purchase notes from all municipal issuers. Initial direct eligibility was therefore limited to U.S. states and a number of large jurisdictions, while smaller jurisdictions were made eligible to issue notes to the MLF indirectly through another eligible state or municipality.

The agencies have subsequently expanded the facility to include multi-state entities, revenue bond issuers, and a broader range of municipalities, in response to feedback identifying legal barriers that would frustrate indirect participation by previously ineligible entities. The agencies also have amended the terms of the MLF to allow more than one issuer per eligible state, city, or county in order to facilitate the provision of assistance to smaller political subdivisions or other government entities. The MLF continues to encourage large eligible issuers to permit indirect participation by their political subdivisions or other governmental entities, however, because it remains logistically infeasible for the Federal Reserve to purchase notes directly from all U.S. municipalities for the reasons described above.

2. *What is the rationale for the population-size criteria that determine the cities and counties eligible for this facility? What are the concerns, if any, about purchasing notes from cities or counties smaller than the thresholds established?*

As described above, the population-size criteria for the MLF were selected to enable that the limited number of feasible issuers be allocated to entities serving the greatest number of people in the shortest timeframe possible. It would not be logistically feasible to purchase notes directly from all U.S. cities and counties, and smaller cities and counties have therefore been limited to indirect participation in the MLF through their respective states. Further, all cities and counties—even those ineligible to directly participate in the facility—have benefited from improving market conditions that have resulted from the presence of the MLF as a backstop to the short-term municipal securities market. By addressing the liquidity needs of larger cities and counties, the MLF frees up credit from private market sources to address the needs of smaller cities and counties. This is already evidenced by the significant increase in bank lending agreements that have been filed with EMMA, the Municipal Securities Rulemaking Board's online disclosure portal, since early April.

3. *Why were U.S. territories excluded from this facility?*

The MLF is open only to entities that were rated investment grade as of the facility's announcement to ensure compliance with provisions of the Federal Reserve Act, the Board's Regulation A, and the CARES Act. For example, under the Federal Reserve Act, FRBNY must assign a lendable value, consistent with sound risk management practices, to all collateral for a loan extended under section 13(3). The security for any loan under the MLF also must protect the taxpayer from losses. Both requirements are furthered by lending only to investment grade borrowers. The CARES Act also provides that the principal amount of any obligation issued by a State or municipality under a facility authorized by section 4003(b) of the Act shall not be reduced through loan forgiveness. This provision substantially restricts the MLF's ability to work out or resolve defaulting notes or other obligations that it has purchased. Restricting access to investment-grade issuers furthers compliance with this restriction by reducing the likelihood that the facility will hold debt that falls into default. Moreover, given the large number and

heterogeneous nature of issuers of municipal debt, it can be difficult to assess and compare their creditworthiness. Credit ratings provide an objective, transparent, and efficient means by which the agencies can assess the risk associated with lending to an issuer.

No U.S. territory is rated investment grade. Given their financial circumstances, additional debt that cannot be forgiven is unlikely to provide U.S. territories with substantial relief. Further, Puerto Rico is in default on its general obligation debt and would therefore be prohibited from accessing the Facility by the Board's Regulation A. Puerto Rico is the only U.S. territory with independent local governments, and the Federal Reserve is not aware of any local Puerto Rican government that carries an investment-grade rating. After Hurricanes Irma and Maria, the U.S. Virgin Islands and its power authority borrowed approximately $300 million from Federal Emergency Management Agency ("FEMA") through its Community Disaster Loan Program and have already sought loan forgiveness for such loans from FEMA because of their limited debt repayment capacity.