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The Federal Reserve's Response to COVID-19: Policy Issues

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SUMMARY

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The Federal Reserve's Response to COVID-19: Policy Issues

The Coronavirus Disease 2019 (COVID-19) pandemic has caused widespread disruptions to the economy. The Federal Reserve (Fed) has taken multiple policy actions in response to the crisis, and Congress has taken the unprecedented step of providing up to $500 billion to the Treasury to support Fed programs through the Coronavirus Aid, Relief, and Economic Security Act (H.R. 748, CARES Act), signed into law as P.L. 116-136 on March 27, 2020.

The Fed has taken a number of steps to promote economic and financial stability in both its monetary policy and its *lender of last resort* roles. Some of these actions are intended to stimulate economic activity by reducing interest rates, and others are intended to provide liquidity so firms have access to needed funding. The Fed acts as a lender of last resort for banks by making short-term loans through the discount window, which it encouraged banks to access and made the borrowing terms more attractive when the pandemic began. Because foreign banks are reliant on U.S. dollar funding but cannot borrow from the discount window, the Fed has also allowed foreign central banks to swap their currencies for hundreds of billions of U.S. dollars so that the central banks can lend those dollars to banks in their jurisdiction.

The Fed set up a series of emergency facilities in response to COVID-19 to expand its lender of last resort role to other sectors of the economy. The Fed created facilities to assist commercial paper markets, corporate bond markets, money market mutual funds, primary dealers, asset-backed securities, states and municipalities, and businesses with up to 15,000 employees or $5 billion in revenues. It also created a facility to make funds available for lenders to make loans to small businesses through the Paycheck Protection Program (another CARES Act program). The Fed charges interest and fees to use these facilities that may increase its net income, but the facilities expose taxpayers to the risk of losses if borrowers default or securities fall in value. To date, Treasury has pledged $215 billion to backstop potential losses on these facilities.

The Fed can ease overall liquidity conditions by entering into repurchase agreements (repos), which are economically equivalent to short-term collateralized loans. In response to the crisis, the Fed has made $1 trillion in overnight repos available at auction every day and has made an additional $500 billion in longer-term repos available at least once a week. Actual take-up rates, however, have been much lower.

The Fed lowered interest rates to stimulate interest-sensitive spending. In March 2020, it reduced short-term interest rates to a range of 0% to 0.25%. The Fed "expects to maintain this target range until it is confident that the economy has weathered recent events and is on track to achieve its maximum employment and price stability goals." Because rates were already comparatively low before March, reducing rates provided relatively limited additional monetary stimulus. To provide more stimulus, the Fed also made large-scale purchases of Treasury securities and mortgage-backed securities in an effort to reduce interest rates generally. Those purchases also added more liquidity to the financial system. The Fed used this tool—popularly referred to as "quantitative easing" (QE)—in the 2007-2009 financial crisis, but its 2020 purchases have been larger. In April alone, the Fed's securities holdings increased by about $1.2 trillion. The Fed has financed all of these activities by expanding its balance sheet, which surpassed its all-time high by March 2020 and exceeded $7 trillion by May 2020.

Fed Chair Jerome Powell said in May 2020, "the Fed has lending powers, not spending powers." Traditionally, financial assistance that goes beyond short-term liquidity to solvent financial firms has been the purview of the federal government, not the Fed. Congress decided in the CARES Act to provide most of the $500 billion for economic stabilization to support Fed—instead of Treasury—programs, however. The House-passed HEROES Act (H.R. 6800) would further expand the recipients of Fed assistance. In principle, the Fed's lender of last resort powers are intended to address illiquidity, not insolvency (i.e., when a business is no longer viable). As the pandemic persists, losses threaten to shift liquidity problems to solvency problems, arguably blurring the line between lending and spending. The more the Fed's COVID-19 response comes to resemble spending, the greater the implications may be for the Fed's political independence.

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Introduction

The Coronavirus Disease 2019 (COVID-19) pandemic has caused unprecedented disruptions to the economy.[1] Business closures and other disruptions to economic activity have caused bankruptcies, high unemployment, and loss of income. How quickly the economy may bounce back after the emergency ends is very uncertain, with the lasting effects likely increasing as the emergency's duration lengthens. In addition to disruption to economic activity, the crisis initially caused a sharp decline in prices and private liquidity in financial markets. Although some financial conditions have improved, and a financial crisis has been averted to date, conditions remain fragile and have not fully recovered to their pre-pandemic state. This could amplify the economic downturn by making credit less available to borrowers.

The Federal Reserve (Fed), as the nation's central bank, was created as a "lender of last resort" to the banking system when private liquidity becomes unavailable.[2] This role is minimal in normal conditions but has been important in periods of financial instability, such as the 2007-2009 financial crisis. Less frequently throughout its history, the Fed has also provided liquidity to firms that were not banks. In the 2007-2009 financial crisis, it provided extensive credit to nonbank financial firms and markets under emergency authority found in Section 13(3) of the Federal Reserve Act (12 U.S.C. Ch. 3).[3] In response to COVID-19, the Fed has gone further than it did in that financial crisis to provide credit to nonfinancial businesses and states and municipalities through a series of emergency facilities.

The Fed's primary responsibility in modern times is monetary policy, which it carries out by targeting short-term interest rates under normal conditions.[4] It sets monetary policy with the aim of achieving its statutory mandate (12 U.S.C. §225a) of "maximum employment, stable prices, and moderate long-term interest rates." The Fed has also taken a number of monetary actions in response to COVID-19. The Fed has also taken actions in its role as a bank regulator, which are not covered in this report (see CRS Insight IN11278, *Bank and Credit Union Regulators' Response to COVID-19*, by Andrew P. Scott and David W. Perkins).

The Fed's powers were granted by Congress, and Congress retains oversight responsibilities for the Fed's actions. In addition to actions the Fed has taken under existing authority, Congress has passed wide-ranging relief legislation in response to the crisis. Such legislation has included provisions related to the Fed. Division A, Title IV of the Coronavirus Aid, Relief, and Economic Security Act (H.R. 748, CARES Act), signed into law as P.L. 116-136 on March 27, 2020, appropriated up to $500 billion through the Exchange Stabilization Fund (ESF) to support the Fed's emergency facilities. For more information, see CRS Report R46329, *Treasury and Federal Reserve Financial Assistance in Title IV of the CARES Act (P.L. 116-136)*, coordinated by Andrew P. Scott. On May 15, 2020, the House passed the HEROES Act (H.R. 6800), which would further extend the Fed's emergency facilities to additional classes of borrowers if enacted.

[1] See CRS Insight IN11388, *COVID-19: U.S. Economic Effects*, by Rena S. Miller and Marc Labonte.

[2] For background, see CRS In Focus IF10054, *Introduction to Financial Services: The Federal Reserve*, by Marc Labonte.

[3] See CRS Report R44185, *Federal Reserve: Emergency Lending*, by Marc Labonte.

[4] For an overview, see CRS Report RL30354, *Monetary Policy and the Federal Reserve: Current Policy and Conditions*, by Marc Labonte.

This report provides an overview of the actions taken by the Fed in response to COVID-19 and discusses policy issues raised by the Fed's expanded role.[5] It then provides a brief discussion of the statutory restrictions surrounding its actions. Finally, the report discusses the Fed provisions of the HEROES Act.

Federal Reserve Actions in Response to COVID-19

In response to COVID-19, the Fed has taken a number of steps to promote economic and financial stability involving its monetary policy and lender of last resort roles. Some of these actions are intended to stimulate economic activity by reducing interest rates, and others are intended to provide liquidity so firms have access to needed funding. In normal conditions, liquidity is plentiful, meaning financial firms can easily borrow in private markets at reasonable interest rates. Financial uncertainty, such as that caused by COVID-19, can cause liquidity to dry up, as creditors become more concerned about default risk. The Fed has taken actions to provide liquidity directly to firms and markets through its emergency lending, discussed in the next section. It has also provided liquidity to markets more broadly (discussed in the "Actions to Provide Overall Market Liquidity" section, below).

Emergency Lending

This section covers actions taken by the Fed in its lender of last resort role—actions intended to provide liquidity directly to firms to ensure they have continued access to needed funding. It carries out its traditional lender of last resort function for banks through its discount window. In 2020, it has also acted as a lender of last resort for nonbank firms and markets by creating a series of emergency lending facilities.

Discount Window

The discount window is the Fed's traditional tool in its lender of last resort function for banks. Healthy banks can borrow on demand from the discount window by pledging their assets as collateral, which minimizes risk to the Fed. In a March 15, 2020, announcement, the Fed encouraged banks to borrow from the Fed's discount window to meet their liquidity needs.[6] The Fed lengthened the maturity of discount window loans to up to 90 days (banks typically borrow from the discount window on an overnight basis). It also reduced the discount rate to the top of the Fed's target for the federal funds rate,[7] so that the discount rate is no longer significantly higher than market rates. Typically, the discount rate is kept above the federal funds rate to discourage use of the discount window. Discount window lending is negligible in normal conditions but has surged since March. It peaked at $50 billion during the week of April 1, 2020; it has fallen since, but remains well above normal levels.

The Fed also encouraged banks to use intraday credit (daylight overdrafts), available through the Fed's payment systems, as a source of liquidity. Banks use intraday credit when their reserve

[5] The Federal Reserve (Fed) has also taken regulatory actions to address Coronavirus Disease 2019 (COVID-19), alone and in concert with other banking regulators. Those actions are not covered in this report.

[6] Federal Reserve, "Federal Reserve Actions to Support the Flow of Credit to Households and Businesses," press release, March 15, 2020, at https://www.federalreserve.gov/newsevents/pressreleases/monetary20200315b.htm. On March 16, 2020, the other federal banking regulators also encouraged banks under their supervision to use the discount window.

[7] The federal funds rate is discussed in the "Federal Funds Rate" section, below.

balances are not large enough to cover lags in the settlement of payments. The Fed typically limits the use of intraday credit because it exposes the Fed to credit risk if a borrower defaults.[8]

Emergency Facilities

In response to the financial disruption caused by COVID-19, the Fed has extended its lender of last resort role beyond the banking system to assist nonbank firms and nonbank financial markets. To date, the Fed has created nine temporary emergency facilities in response to COVID-19. The first wave of Fed programs announced in March was an attempt to stabilize overall credit market conditions, which experienced illiquidity in the wake of the rapid spread of COVID-19. Later programs were more focused on helping businesses and municipalities that were harmed by the economic disruption caused by COVID-19.

These programs are set up in different ways. In some programs, the Fed purchases loans or securities in affected markets directly. In other programs, the Fed makes loans directly to affected entities. In others, the Fed makes loans to (or purchases loans from) financial institutions or investors so that they will intervene in affected markets; these loans are typically made on attractive terms to incentivize activity, including by shifting the credit risk to the Fed by making the loans on a nonrecourse basis.[9]

Seven of these programs are backed by funds from Treasury's ESF:[10]

- **Commercial Paper Funding Facility (CPFF).** The CPFF purchases newly-issued commercial paper from all types of U.S. issuers that cannot find private sector buyers.[11] *Commercial paper* is short-term debt issued by financial firms (including banks), nonfinancial firms, municipalities, and pass-through entities that issue asset-backed securities (ABS) backed by loans.[12]
- **Money Market Fund Liquidity Facility (MMLF).** The MMLF makes nonrecourse loans to financial institutions to purchase assets that money market funds are selling to meet redemptions.[13] This reduces the probability of runs on money market funds caused by a fund's inability to liquidate assets.[14] On March 19, 2020, the banking regulators issued an interim final rule so that these loans

[8] For more information, see Federal Reserve, *Policy on Payment System Risk*, October 2020, at https://www.federalreserve.gov/paymentsystems/files/psr_2020_policy.pdf.

[9] Recourse requires the borrower to repay even if the value of the collateral falls below the value of the debt.

[10] For more information, see CRS In Focus IF11474, *Treasury's Exchange Stabilization Fund and COVID-19*, by Marc Labonte, Baird Webel, and Martin A. Weiss.

[11] Federal Reserve, "Federal Reserve Board Announces Establishment of a Commercial Paper Funding Facility (CPFF) to Support the Flow of Credit to Households and Businesses," press release, March 17, 2020, at https://www.federalreserve.gov/newsevents/pressreleases/monetary20200317a.htm.

[12] Official resources and reports on the CPFF are available at https://www.federalreserve.gov/monetarypolicy/cpff.htm and https://www.newyorkfed.org/markets/commercial-paper-funding-facility. See also Nina Boyarchenko, Richard Crump, and Anna Kovner, "The Commercial Paper Funding Facility," *Liberty Street Economics*, Federal Reserve Bank of New York, May 15, 2020, at https://libertystreeteconomics.newyorkfed.org/2020/05/the-commercial-paper-funding-facility.html; and CRS Insight IN11332, *COVID-19: Commercial Paper Market Strains and Federal Government Support*, by Rena S. Miller.

[13] Federal Reserve, "Federal Reserve Board broadens program of support for the flow of credit to households and businesses by establishing a Money Market Mutual Fund Liquidity Facility (MMLF)," press release, March 18, 2020, at https://www.federalreserve.gov/newsevents/pressreleases/monetary20200318a.htm.

[14] For more on money market mutual funds, see CRS In Focus IF11320, *Money Market Mutual Funds: A Financial Stability Case Study*, by Eva Su.

would not affect the borrowing bank's compliance with regulatory capital requirements.[15]

- **Primary Market Corporate Credit Facility (PMCCF) and Secondary Market Corporate Credit Facility (SMCCF).** The Fed created two new facilities to support corporate bond markets—(1) the PMCCF to purchase newly-issued corporate debt and syndicated loans from issuers and (2) the SMCCF to purchase existing corporate debt or corporate debt exchange-traded funds (ETFs) on secondary markets.[16] The issuer must have material operations in the United States and cannot receive direct financial assistance from other federal programs related to COVID-19, such as CARES Act programs.[17]
- **Term Asset-Backed Securities Loan Facility (TALF).** To support ABS markets,[18] the TALF makes nonrecourse, three-year loans to private investors to purchase newly-issued, highly-rated ABS backed by various types of loans other than residential mortgages.[19] Eligible ABS include those backed by certain auto loans, student loans, credit card receivables, equipment loans, floorplan loans, insurance premium finance loans, small business loans guaranteed by the Small Business Administration (SBA), commercial real estate, leveraged loans, or servicing advance receivables.[20]
- **Main Street Lending Program (MSLP).** The MSLP buys new or expanded loans from banks or credit unions to businesses with up to 15,000 employees or up to $5 billion in revenues. These loans are to be five-year loans with deferred principal repayment for two years and interest repayment for one year, and the businesses would have to make a "commercially reasonable effort" to retain employees. This program may be particularly attractive to businesses too large to

[15] Federal Reserve, Federal Deposit Insurance Corporation, and Office of the Comptroller of the Currency, "Federal Bank Regulatory Agencies Issue Interim Final Rule for Money Market Liquidity Facility," joint press release, March 19, 2020, at https://www.federalreserve.gov/newsevents/pressreleases/monetary20200319a.htm. Official resources and reports on the MMLF are available at https://www.federalreserve.gov/monetarypolicy/mmlf.htm. For background, see Marco Cipriani et al., "The Money Market Mutual Fund Liquidity Facility," *Liberty Street Economics*, Federal Reserve Bank of New York, May 8, 2020, at https://libertystreeteconomics.newyorkfed.org/2020/05/the-money-market-mutual-fund-liquidity-facility.html.

[16] Federal Reserve, "Federal Reserve Announces Extensive New Measures to Support the Economy," press release, March 23, 2020, at https://www.federalreserve.gov/newsevents/pressreleases/monetary20200323b.htm (hereinafter cited as Federal Reserve, "New Measures to Support the Economy").

[17] Official resources and reports on the Primary Market Corporate Credit Facility (PMCCF) are available at https://www.federalreserve.gov/monetarypolicy/pmccf.htm and https://www.newyorkfed.org/markets/primary-Market-corporate-credit-facility. Official resources and reports on the Secondary Market Corporate Credit Facility (SMCCF) are available at https://www.federalreserve.gov/monetarypolicy/smccf.htm and https://www.newyorkfed.org/markets/secondary-market-corporate-credit-facility. For background, see Nina Boyarchenko et al, "The Primary and Secondary Market Corporate Credit Facilities," *Liberty Street Economics*, Federal Reserve Bank of New York, May 26, 2020, at https://libertystreeteconomics.newyorkfed.org/2020/05/the-primary-and-secondary-market-corporate-credit-facilities.html.

[18] Asset-backed securities (ABS) are created when a securitizer issues securities backed by a pool of loans and sells them to investors. The payments on those loans flow to the holders of the ABS.

[19] Federal Reserve, "New Measures to Support the Economy."

[20] Official resources and reports on the Term Asset-Backed Securities Loan Facility (TALF) are available at https://www.federalreserve.gov/monetarypolicy/talf.htm and https://www.newyorkfed.org/markets/term-asset-backed-securities-loan-facility.

qualify for SBA assistance, such as the CARES Act's Paycheck Protection Program (PPP).[21]

- **Municipal Liquidity Facility (MLF).** The MLF purchases shorter-term state and municipal debt in response to higher yields and reduced liquidity in that market. The facility purchases only debt in anticipation of taxes or dedicated revenues of states, larger counties (with at least 500,000 residents), and larger cities (with at least 250,000 residents). However, states without at least two counties and cities that meet the minimum population limit can designate any combination of their two largest counties or cities to participate.[22]

Two other emergency programs are not backed by the ESF:

- **Primary Dealer Credit Facility (PDCF).** The PDCF provides liquidity to primary dealers,[23] a group of large government securities dealers that are market makers in securities markets and are the Fed's traditional counterparties for open market operations.[24] Like banks, primary dealers are heavily reliant on short-term lending markets in their role as securities market makers. Unlike banks, they cannot access the discount window. Like the discount window, the PDCF provides short-term, fully collateralized loans to primary dealers.[25]
- **Paycheck Protection Program Lending Facility (PPPLF).** The PPPLF provides credit to financial institutions making loans under the CARES Act's PPP.[26] Because banks are not required to hold capital against these loans, this facility increases lending capacity for banks facing high demand to originate these loans. The PPP provides low-cost loans to small businesses to pay employees. These loans do not pose credit risk to the Fed because they are guaranteed by the SBA.[27]

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[21] Official resources and reports on the Main Street Lending Program (MSLP) are available at https://www.federalreserve.gov/monetarypolicy/mainstreetlending.htm and https://www.bostonfed.org/supervision-and-regulation/supervision/special-facilities/main-street-lending-program.aspx.

[22] Official resources and reports on the Municipal Liquidity Facility (MLF) are available at https://www.federalreserve.gov/monetarypolicy/muni.htm and https://www.newyorkfed.org/markets/municipal-liquidity-facility. For background, see Andrew F. Haughwout, Benjamin G. Hyman, and Matthew Lieber, "Helping State and Local Governments Stay Liquid," *Liberty Street Economics*, Federal Reserve Bank of New York, April 10, 2020, at https://libertystreeteconomics.newyorkfed.org/2020/04/helping-state-and-local-governments-stay-liquid.html.

[23] For a list of current primary dealers and more information about their relationships with the Fed, see https://www.newyorkfed.org/markets/primarydealers.

[24] Federal Reserve, "Federal Reserve Board Announces Establishment of a Primary Dealer Credit Facility (PDCF) To Support the Credit Needs of Households and Businesses," press release, March 17, 2020, at https://www.federalreserve.gov/newsevents/pressreleases/monetary20200317b.htm.

[25] Official resources and reports on the PDCF are available at https://www.federalreserve.gov/monetarypolicy/pdcf.htm and https://www.newyorkfed.org/markets/primary-dealer-credit-facility. For background, see Antoine Martin and Susan McLaughlin, "The Primary Dealer Credit Facility," *Liberty Street Economics*, Federal Reserve Bank of New York, May 19, 2020, at https://libertystreeteconomics.newyorkfed.org/2020/05/the-primary-dealer-credit-facility.html.

[26] Federal Reserve, "Federal Reserve Will Establish A Facility To Facilitate Lending To Small Businesses Via The Small Business Administration's Paycheck Protection Program (PPP) By Providing Term Financing Backed By PPP Loans," press release, April 6, 2020, at https://www.federalreserve.gov/newsevents/pressreleases/monetary20200406a.htm. For more on the PPP and other relief for small businesses, see CRS Report R46284, *COVID-19 Relief Assistance to Small Businesses: Issues and Policy Options*, by Robert Jay Dilger, Bruce R. Lindsay, and Sean Lowry.

[27] Official resources and reports on the PPPLF are available at https://www.federalreserve.gov/monetarypolicy/ppplf.htm and https://www.frbdiscountwindow.org/generalpages/emergency%20credit%202020. See also Haoyang Liu

Comparison with 2008 Federal Reserve Facilities

In response to the 2007-2009 financial crisis, the Fed created a series of emergency credit facilities in 2008 to support liquidity in the nonbank financial system for the first time since the Great Depression. The CPFF, PDCF, MMLF, and TALF revive 2008 facilities, with some modifications to the terms of the facilities.[28] The PMCCF, SMCCF, MSLP, MLF, and PPPLF are new and go beyond the scope of the 2008 facilities by purchasing loans of nonfinancial businesses and debt of states and municipalities.

It is too soon to predict how much assistance the Fed will extend under the COVID-19 facilities, but in 2008, credit outstanding under Section 13(3) of the Federal Reserve Act (12 U.S.C. §343) peaked at $710 billion.[29] This does not represent the "cost" to the Fed or taxpayers; it represents the peak amount that was extended. In hindsight, there was no direct cost to the Fed or taxpayers because all loans were repaid with interest, and the securities were sold at a higher price than they were purchased overall. Instead, the Fed's overall remittances to Treasury more than doubled. That does not guarantee that there will be no cost to the Fed's COVID-19 interventions, but it does mean that any losses (or profits) will be significantly smaller than the amount outstanding.

Exchange Stabilization Fund Funding to Backstop Potential Losses

The 2020 facilities were all created under Section 13(3) of the Federal Reserve Act. Under Section 13(3), the Fed must structure these facilities to avoid expected losses. To limit risk, some of the facilities require collateral, limit maturity length on loans or debt, or limit eligibility by credit ratings. Facilities also charge users interest, fees, or both as compensation. Treasury has pledged ESF funds, which were augmented by the CARES Act, for most of these facilities to protect the Fed from future losses—although these losses would still be borne by the federal government.[30] The Fed deemed two facilities (the PDCF and the PPPLF) to be less risky, and those facilities are not backed by ESF funds. The PPPLF is less risky because PPP loans are guaranteed by the federal government. There was far more limited use of Treasury funding to back Fed facilities created in 2008.[31]

Use of Special Purpose Vehicles

Many of these facilities are structured as special purpose vehicles (SPVs) or limited liability corporations (LLCs) that are created, controlled, and operated by the Fed—an accounting structure first used in 2008. The Fed lends to the facility to make loans to or purchase assets of distressed borrowers. The securities purchased by the SPVs back the loans to the SPVs, thereby fulfilling the statutory requirement that the Fed's loans be collateralized. Treasury uses CARES Act funding to make an equity investment in the facility. Future net losses on the facility would

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and Desi Volker, "The Paycheck Protection Program Liquidity Facility (PPPLF)," *Liberty Street Economics*, Federal Reserve Bank of New York, May 20, 2020, at https://libertystreeteconomics.newyorkfed.org/2020/05/the-paycheck-protection-program-liquidity-facility-ppplf.html.

[28] The MMLF is very similar to the 2008 Asset-Backed Commercial Paper Money Market Mutual Fund Liquidity Facility (AMLF) but accepts a wider range of collateral than the AMLF accepted in 2008.

[29] See CRS Report R44185, *Federal Reserve: Emergency Lending*, by Marc Labonte.

[30] The Exchange Stabilization Fund (ESF) was not used to backstop 13(3) programs in 2008, but some programs were backed by other Treasury funds.

[31] For example, Treasury used funds from Treasury's Troubled Asset Relief Program (TARP) to back TALF in 2009.

reduce Treasury's equity position. If losses do not materialize, CARES Act funds could be redeployed, as occurred with Fed facilities after the 2007-2009 financial crisis.[32]

This structure facilitates the pooling of Fed and Treasury funds and avoids legal restrictions on the purchase of assets that are ineligible for purchase under the Federal Reserve Act, such as corporate debt. Since the Fed's creation, financial activity has shifted in relative terms away from bank loans and toward securities, such as debt and equity, traded in capital markets. The Federal Reserve Act has not been changed to accommodate that shift. Were the Fed to limit itself solely to making emergency loans, it would be harder for the Fed to reach certain parts of capital markets. When the Fed's emergency authority was amended by the Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank Act; P.L. 111-203), the act neither explicitly authorized nor prohibited the use of SPVs (see the "Section 13(3) of the Federal Reserve Act" section, below).

Although legally separated from the Fed, income and losses from the SPVs still flow to the Fed (and Treasury, in cases where ESF funds are pledged), and the SPVs appear on the Fed's consolidated balance sheet. In legal terms, the Fed has made a secured loan, but in economic terms, it has purchased an asset—it cannot make a secured loan to itself.

Program Size

The Fed funds the facilities' loans and asset purchases using its own resources backed by the ESF in the event of losses. The text box below describes how these programs affect the Fed's balance sheet.

The Effect of the Federal Reserve's COVID-19 Response on Its Balance Sheet

The Federal Reserve (Fed) finances its emergency facilities, securities purchases, repurchase agreements, and other Coronavirus Disease 2019 (COVID-19) responses (see the "Monetary Policy" section, below) by expanding its balance sheet. The balance sheet increased from $4.7 trillion on March 19, 2020, to $7 trillion on May 20, 2020.[33] There is virtually no constraint on how much the Fed can expand its balance sheet, other than its general mandated goal of maintaining price stability. Loans outstanding and securities holdings appear on the asset side of its balance sheet. On the liability side, the Fed creates bank reserves, which flow through banks to recipients or sellers, respectively.

The Fed earns interest on its securities holdings and lending, and it uses this interest to fund its operations. (It receives no appropriations from Congress.) The Fed's income exceeds its expenses, and it remits most of its net income (akin to profits) to Treasury, which uses it to reduce the budget deficit. Although the increases in direct lending and securities in response to COVID-19 increase the potential riskiness of the Fed's balance sheet, they are also likely to increase its net income. The Fed's actions in response to COVID-19 are profitable to the Fed (and therefore the taxpayer) if they yield a higher rate of return than the interest the Fed pays on bank reserves. Because the interest rates on these securities and lending facilities are generally higher than the interest it pays on bank reserves, the COVID-19 response will reduce the federal budget deficit unless losses on these programs and securities are large. Following a similar expansion in the Fed's balance sheet during the financial crisis, the Fed's remittances to Treasury rose from $35 billion in 2007 to more than $75 billion annually from 2010 to 2017.

The Fed has discretion to set overall size limits, if any, on these facilities. Some programs backed by ESF funding were announced with an overall size limit. During the 2007-2009 financial crisis, however, actual activity typically did not match the announced size. In some cases, demand proved greater than expected, and the size limit was increased. In other cases, demand fell short,

[32] If Treasury wished to redeploy CARES Act funding, the act only allows Treasury to enter into new contracts until the end of 2020.

[33] All Federal Reserve data for May 20 in this section are taken from Federal Reserve, "Factors Affecting Reserve Balances - H.4.1," at https://www.federalreserve.gov/releases/h41/.

and actual activity fell far short of the announced size. **Table 1** summarizes how much ESF funding has been pledged to each facility. In total, $215 billion has been pledged to date.

Table 1. Federal Reserve COVID-19 Emergency Programs

billions of dollars

	Announced Size Limit	Exchange Stabilization Fund Funds Pledged
Facilities Created Prior to Enactment of CARES Act		
Commercial Paper Funding Facility	n/a	$10
Primary Dealer Credit Facility	n/a	$0
Money Market Fund Liquidity Facility	n/a	$10
Primary Market Corporate Credit Facility/Secondary Market Corporate Credit Facility	$750	$75
Term Asset-Backed Securities Loan Facility	$100	$10
Facilities Created Since Enactment of CARES Act		
Paycheck Protection Program (PPP) Lending Facility	n/a[a]	$0
Main Street Lending Program	$600	$75
Municipal Liquidity Facility	$500	$35
Total	**n/a**	**$215**

Source: Congressional Research Service (CRS).

a. Although the PPP has a statutory size limit, the Fed's lending facility does not.

"Leveraging" CARES Act Funding

The CARES Act provided up to between $454 billion and $500 billion to the ESF to support the Fed's COVID-19 response, as discussed in the "Authority Used in the Federal Reserve's COVID-19 Response" section, below. Some of the Fed's emergency facilities are now backed by CARES Act funding. There has been talk of how the Fed can "leverage" the CARES Act funding into greater amounts of assistance by combining it with the Fed's funds.[34] Although the use of the term leverage is more colloquial than technical from a financial perspective, **Table 1** illustrates how this is accomplished. For example, the MLF is planning to purchase up to $500 billion of assets using $35 billion of CARES Act funding.

Tracking Activities of Federal Reserve Emergency Programs

As required by law, the Fed has issued reports to Congress describing the purpose and details of each facility.[35] Total loans or asset purchases through the facilities are published weekly as part of

[34] See, for example, Jeanna Smialek, "How the Fed's Magic Money Machine Will Turn $454 Billion Into $4 Trillion," *New York Times*, March 26, 2020, at https://www.nytimes.com/2020/03/26/business/economy/fed-coronavirus-stimulus.html.

[35] See Federal Reserve, "Reports to Congress Pursuant to Section 13(3) of the Federal Reserve Act in response to COVID-19," at https://www.federalreserve.gov/publications/reports-to-congress-in-response-to-covid-19.htm.

the Fed's balance sheet.[36] The Fed also announced that it would publicly report on transactions under CARES Act 13(3) facilities at least every 30 days. Details of the report are to include, "names and details of participants in each facility; amounts borrowed and interest rate charged; and overall costs, revenues, and fees for each facility."[37] In the past, the Fed has provided details on emergency facilities' activities in quarterly reports.[38]

Policy Issues

Background

Financial markets fundamentally involve liquidity mismatches—some financial firms hold assets that are less liquid than their liabilities. For example, banks hold loans as assets that are difficult to sell quickly and hold deposits as liabilities that, in some cases, can be withdrawn on demand. In normal conditions, when fear of default is low and private liquidity is plentiful, liquidity mismatches typically pose no problem. In periods of financial turmoil, fear of default rises, private liquidity is withdrawn, and a financial crisis may result. Congress passed the Federal Reserve Act in 1913, after multiple financial crises, to create a lender of last resort. As lender of last resort, the Fed could step in and provide unlimited liquidity (through its ability to create money) when private liquidity became unavailable.

Illiquidity is not the only reason a firm might fail. A firm could also fail because it is insolvent (i.e., because its liabilities exceed its assets). The purpose of a lender of last resort is to prevent a solvent firm from failing because it is illiquid.

Role of the Federal Reserve in COVID-19

The Fed's unprecedented policy response to the economic disruption caused by COVID-19 raises a number of policy issues, but many of those have one fundamental issue at their root: what are the appropriate limits on the Fed's lender of last resort role? One often-cited dictum by Walter Bagehot, a 19th century author, is "to avert panic, central banks should lend early and freely … to solvent firms, against good collateral, and at 'high rates'."[39] This dictum is widely accepted among central bankers and economists, but each clause raises new questions: how early; how freely; what types of firms; what is good collateral; and how high should rates be?

For most of the Fed's more than 100 years of existence, it has answered those questions by limiting the discount window to short-term, fully collateralized loans with recourse to well-capitalized banks at above-market interest rates.[40] In three episodes, the Fed has significantly

[36] See Federal Reserve, "Factors Affecting Reserve Balances - H.4.1," various dates, available at https://www.federalreserve.gov/releases/h41/.

[37] Federal Reserve, "Federal Reserve Board outlines the extensive and timely public information it will make available regarding its programs to support the flow of credit to households and businesses and thereby foster economic recovery," press release, April 23, 2020, at https://www.federalreserve.gov/newsevents/pressreleases/monetary20200423a.htm.

[38] See Federal Reserve, "Quarterly Report on Federal Reserve Balance Sheet Developments," various dates, available at https://www.federalreserve.gov/monetarypolicy/quarterly-balance-sheet-developments-report.htm.

[39] This formulation of Bagehot's dictum is by Paul Tucker, formerly of the Bank of England. See Paul Tucker, "The Repertoire of Official Sector Interventions in the Financial System: Last Resort Lending, Market-Making, and Capital," speech at the Bank of Japan 2009 International Conference, Tokyo, May 28, 2009, at https://www.bankofengland.co.uk/speech/2009/last-resort-lending-market-making-and-capital.

[40] *Collateralized loans* are loans backed by some other asset. In other words, the creditor can seize the borrower's asset if the borrower fails to repay the loan. *Secured debt* is debt backed by collateral or some other third-party financial guarantee. Recourse requires the borrower to repay even if the value of the collateral falls below the value of the debt.

loosened and extended those terms in the face of serious economic disruption—during the Great Depression, the 2007-2009 financial crisis, and the COVID-19 pandemic.

But even compared with those two previous economic crises, the Fed's COVID-19 response stands apart in the context of each of the questions posed above (see **Table 2**.) In some cases, assistance has been unsecured and on a nonrecourse basis. The Fed has extended its lending function to include the purchase of securities, which typically cannot be secured or collateralized. It has created lending facilities for nonfinancial firms and municipalities that have seen their revenues collapse. It has made facilities broadly accessible; in some cases, it has opened facilities to firms or securities that are no longer investment grade or are too small to have credit ratings. It has committed assistance preemptively, before a lack of access to private credit has been established. For some facilities, it has charged interest rates that are significantly higher than riskless interest rates, but in others, the markup is small. It has made assistance available for between 90 days and five years.

Table 2. Comparing Federal Reserve Emergency Facilities

Fed Facility	Ultimate Beneficiary[a]	What is the Fed Doing?[b]	Fed's Protection Against Losses[b]	Length to Maturity
Discount Window	Banks	Making loan	Overcollateralized, recourse, access limited for undercapitalized banks	Typically, overnight; currently up to 90 days
Commercial Paper Funding Facility	Commercial paper issuers (nonfinancial firms, nonbank financial firms, securitizers)	Purchasing securities	Access limited to firms rated A1/P1/F1 before March 17, 2020; Exchange Stabilization Fund (ESF) backing	Three months
Primary Dealer Credit Facility	Primary dealers	Making loan	Overcollateralized, recourse	Up to 90 days
Money Market Fund Liquidity Facility	Money market funds	Making nonrecourse loan	Collateralized by highly-rated securities sold by money market funds; ESF backing	Up to one year (loan matches pledged security's maturity date)
Primary Market Corporate Credit Facility (PMCCF)/Secondary Market Corporate Credit Facility (SMCCF)	Bond issuers (nonfinancial firms, nonbank financial firms)	Purchasing securities and syndicated loans	Limited to bonds rated investment grade before March 22, 2020; ESF backing	Up to four years for PMCCF and five years for SMCCF
Term Asset-Backed Securities Loan Facility	Asset-Backed Securities issuers	Making nonrecourse loan	Overcollateralized by ABS with highest rating; ESF backing	Three years
Paycheck Protection Program (PPP) Lending Facility	PPP recipients (small businesses)	Making nonrecourse loan	Collateralized by Small Business Administration-guaranteed PPP loans	Equal to maturity on collateral

Fed Facility	Ultimate Beneficiary[a]	What is the Fed Doing?[b]	Fed's Protection Against Losses[b]	Length to Maturity
Main Street Lending Program	Nonfinancial businesses with up to 15,000 employees or $5 billion in revenues	Purchasing loans	Leverage limitations on borrower; loan is senior to borrower's other debt; lender retains fraction of loan and shares risk; ESF backing	Five years
Municipal Liquidity Facility	States, counties, cities	Purchasing securities	Securities backed by taxes or revenues; rated investment grade before April 8, 2020; ESF backing	Up to three years

Source: CRS, based on various Federal Reserve documents.

Notes: See main body of report for details. Simplified for brevity.

a. For each program, beneficiaries are limited to those who meet all eligibility criteria.

b. For programs involving special purpose vehicles (SPVs), the table is written from the perspective of the SPV's owner (the Fed).

As discussed below, there are statutory restrictions intended to prevent the Fed from rescuing an insolvent bank or business. The Fed is required to sufficiently secure its assistance to protect taxpayers against risk. Some facilities arguably meet this requirement—they have all the traditional protections, and similar facilities did not expose the Fed to any losses during the past financial crisis. In riskier facilities, CARES Act funds have been used to protect the Fed—taxpayers are still exposed to losses, but through the money that Congress appropriated to Treasury, rather than the Fed.

When the Fed began its intervention in March 2020, a case could be made that the main problem facing financial markets was a liquidity freeze. At that point, markets were unsettled and the economic disruption had been brief—businesses could have plausibly needed only short-term cash to tide them over until economic activity recovered, without any lasting effect on their solvency. As the pandemic continues, the preeminent problem has arguably shifted from liquidity to solvency. Soon after the Fed's facilities were established (and before some were operational) and the CARES Act was enacted, financial markets had mostly resumed their normal functioning, and firms with good credit ratings were mostly able to regain access to debt markets.[41] But other businesses still find their operations disrupted and demand for their products constrained. As economic disruption persists, more firms will become insolvent—due to long-lasting business disruptions and depressed spending, or because demand for their products is permanently lower.

In this financial environment, some Fed programs may be accessed largely by borrowers whose future viability is unclear, and there is the potential for "throwing good money after bad." The Fed faces a trade-off between its programs' risk and efficacy. If it were too easy to access Fed facilities, then there would be more losses associated with those facilities, which would ultimately be borne by taxpayers; this may feed public perceptions that the Fed is bailing out failing firms. If

[41] Matt Wirz, "Fed Promised to Buy Bonds but Is Finding Few Takers," *Wall Street Journal*, June 3, 2020, at https://www.wsj.com/articles/fed-promised-to-buy-bonds-but-is-finding-few-takers-11591176601.

it were too difficult to access Fed facilities, then risk to the Fed would be minimized; the facilities' uses, however, would be too low to serve their purpose of ensuring borrowers frozen out of private markets receive liquidity or those suffering economic harm from COVID-19 are helped.[42]

As the crisis shifts from illiquidity to insolvency, there will be losses in credit markets that someone must bear. These losses can be borne by borrowers, creditors, the government, or the Fed. It may be economically and socially optimal to shift some of those losses away from borrowers and creditors—if doing so would minimize future losses and allow private credit to continue flowing, the economic downturn would be less severe.[43] There is little clarity on how large these losses are at this point, but they will continue to grow until economic normalcy returns.

Potential Implications for Federal Reserve Independence

As the pandemic continues and losses grow, this raises a question—where is the line between activities that should be undertaken by Treasury, part of an Administration that is directly accountable to voters and subject to greater congressional checks on its actions, and the politically independent Fed?

In a speech in May 2020, Fed Chair Jerome Powell stated that

> the Fed has lending powers, not spending powers. A loan from a Fed facility can provide a bridge across temporary interruptions to liquidity, and those loans will help many borrowers get through the current crisis. But the recovery may take some time to gather momentum, and the passage of time can turn liquidity problems into solvency problems.[44]

Chair Powell's distinction offers one possible dividing line between the role of Treasury and the Fed—the Fed could provide short-term liquidity to solvent borrowers, and Treasury could address solvency concerns. This distinction is not just hypothetical—reportedly, Treasury's proposal to Congress requested that the CARES Act funding to the ESF be used by Treasury to make loans and loan guarantees to businesses directly.[45] Congress decided instead to direct the bulk of that money to the Fed; Treasury decides how much CARES Act funds should backstop each Fed program, but the Fed designs and administers those programs. In principle, all Fed programs backed by CARES Act funding could have been administered by Treasury instead.[46]

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[42] Bill Dudley, "Fed Lending Faces a Tough Slog on Main Street," *Bloomberg*, April 29, 2020, at https://www.bloomberg.com/opinion/articles/2020-04-29/coronavirus-fed-lending-to-main-street-is-harder-than-it-looks.

[43] In the extreme, if shifting losses to the public sector were to prevent a financial crisis, then doing so would be less costly to the economy (in terms of future gross domestic product) than imposing those losses on the private sector; and doing so might even be less costly to the government overall than the further automatic increase in means-tested spending and decline in tax revenues that would accompany a crisis.

[44] Federal Reserve Chair Jerome Powell, "Current Economic Issues," speech delivered at the Peterson Institute for International Economics, Washington, DC, May 13, 2020, at https://www.federalreserve.gov/newsevents/speech/powell20200513a.htm.

[45] U.S. Treasury, *Stage Three Proposal*, March 18, 2020 at https://www.washingtonpost.com/context/department-of-treasury-proposal-for-coronavirus-response/6c2d2ed5-a18b-43d2-8124-28d394fa51ff/.

[46] It is debatable whether Treasury could have financed all of these programs. (It is not currently constrained by a statutory debt limit.) Near zero interest rates mean that Treasury could, in principle, finance these programs at a lower risk-adjusted rate than it charged borrowers. Near zero interest rates also imply that there is a large demand among investors for more federal debt. In principle, the Fed could have funded these programs directly or indirectly while Treasury administered them, in which case there would be no financing concern for Treasury.

Having the Fed administer these programs instead of Treasury has potential advantages and disadvantages. In a crisis, the Fed can arguably move more quickly than Treasury because it is less constrained, for better or worse, by normal legislative and executive branch checks on its activities. The Fed may have more expertise in operating such programs, although it contracts out some more complex tasks to private-sector vendors. This expertise may also improve the delivery time and effectiveness of assistance. In addition, the "off budget" nature of the Fed's operations may obscure the facilities' cost from taxpayers, although the true cost to taxpayers is the same as if the programs were located in Treasury.

Arguably the greatest concern for many, at least in the long-term performance of these programs, is deciding who receives assistance. For example, who is deserving of assistance because they were disproportionately affected by the pandemic through no fault of their own? Critics have complained that the Fed has not made facilities available to nonprofits, mortgage servicers, and small municipalities, among others. The Fed is a less political, more technocratic entity than Treasury. There are possible advantages to assistance being made in a technocratic, apolitical fashion. At first glance, it may be appealing to think that decisions about access can be separated from politics. But deciding which markets, business lines, and noncommercial entities should and should not be eligible to access a facility involves tradeoffs that are inherently political. In other cases, the Fed has expanded access to facilities in response to criticism. An apolitical, technocratic entity may struggle with those tradeoffs and may become more politicized—or at least subject to more political pressure—when making those tradeoffs. The justification for the Fed's independence is typically posited in terms of its need to make monetary policy decisions that are arguably technocratic and apolitical in nature. The more the Fed's focus shifts from monetary policy to lending, the more political pressure it may face and the weaker the argument for its independence.

The Federal Reserve's Response and Inequality

The political implications of the Fed's interventions can be seen in the questions the interventions have raised about fairness. Some critics complain that the immediate beneficiaries of the Fed's interventions are the owners of securities and businesses, to the exclusion of more deserving beneficiaries.[47] It is difficult, but perhaps not impossible, for the Fed to avoid its interventions resulting in higher asset prices in the short-term because it is required to receive something of value (e.g., a loan or security) in return when it injects liquidity into the economy.[48] Although securities holders and borrowers are the proximate beneficiaries of the Fed's interventions, they are not necessarily the ultimate beneficiaries. If markets were perfectly competitive, the Fed's actions would translate to lower interest rates and more credit that would benefit borrowers, not financial intermediaries.

Because the immediate beneficiaries of the Fed's interventions are the owners of securities and businesses, critics also claim that the Fed's actions have increased income inequality. This analysis is incomplete. To evaluate the effect of the Fed's actions on overall inequality would require considering all of the effects these actions have had on the economy and the income distribution. For example, if the Fed's actions have reduced unemployment from what it would have otherwise been, that would tend to reduce inequality. Estimating the relative contribution of

[47] See, for example, Matt Taibbi, "How the COVID-19 Bailout Gave Wall Street a No-Lose Casino," *Rolling Stone*, May 13, 2020, at https://www.rollingstone.com/politics/politics-features/taibbi-covid-19-bailout-wall-street-997342/.

[48] The Fed can and does purchase federal debt, but if its COVID-19 response had been limited to federal debt purchases, its economic effects would have been more indirect and limited (since yields on U.S. Treasuries are near zero).

these various factors to calculate the net effects of the Fed's actions on overall inequality is beyond the scope of this report.

The Federal Reserve's Response and Moral Hazard

A particular concern coming out of the 2007-2009 financial crisis was how the Fed's interventions would affect moral hazard. *Moral hazard* is the concept that if individuals do not expect to fully bear the negative consequences of their actions, they will act more recklessly. In the context of a financial crisis, moral hazard could occur if the Fed's interventions created an expectation that the Fed would similarly intervene in future market downturns to shield financial market participants from losses, encouraging them to take on greater risk in search of larger profits in the future. Ironically, if the Fed's actions to prevent a crisis resulted in greater risk-taking, it could make future crises more likely. The Dodd-Frank Act attempted to reduce moral hazard by placing statutory restrictions on the Fed's ability to aid failing firms.[49]

One view, articulated by Fed Vice Chair Richard Clarida and others, is that the Fed's COVID-19 response poses no moral hazard because a disruptive global pandemic is, literally, a once-in-a-century occurrence (the last comparable one was in 1918).[50] Therefore, no economic actor could have possibly foreseen it and decided not to safeguard themselves against it because of an expectation that the Fed would bail them out.

Although the current pandemic may be a once-in-a-century event, it is also the second time in just over a decade that the Fed has committed hundreds of billions of dollars in assistance under emergency authority to entities that it does not regulate for safety and soundness to prevent excessive risk-taking. Perhaps most striking is that some emergency programs were announced in March 2020, before there was time to verify the scope of economic damage. In hindsight, the economic disruption proved to be extreme, but many of the financial market losses were reversed after March.[51] There has been an expectation among some that the Fed will intervene in some fashion every time there are major losses in financial markets in ways that then make securities more valuable, at least in the short run. In the 1980s, this was called the "Greenspan put," after the Fed lowered interest rates in response to a drop in the stock market in 1987.

The Fed argues that monetary policy responds only to developments that would affect economic growth or inflation,[52] but if the Fed believes that any significant market decline affects either, then the "Greenspan put" becomes self-fulfilling. If true—or if market participants believe it to be true—then it would be profitable for firms and investors to take on risk at an above socially optimal level.[53] For example, firms increasingly strategically positioned themselves during the last expansion to issue debt that was rated in the lowest investment grade category—one grade

[49] The debate about its efficacy is reviewed in CRS Report R42150, *Systemically Important or "Too Big to Fail" Financial Institutions*, by Marc Labonte.

[50] Brian Chappatta, "Fed's High-Yield ETF Buying Defies Explanation," *Bloomberg*, April 14, 2020, at https://www.bloomberg.com/opinion/articles/2020-04-14/federal-reserve-s-high-yield-etf-buying-defies-explanation.

[51] Market conditions had normalized before some Fed programs have become operational, raising questions about whether the statutory requirement that the borrower must be "unable to secure adequate credit accommodations from other banking institutions" has still been met.

[52] Federal Reserve Governor Frederic S. Mishkin, "How Should We Respond to Asset Price Bubbles?" speech delivered at the Wharton Financial Institutions Center and Oliver Wyman Institute's Annual Financial Risk Roundtable, Philadelphia, PA, May 15, 2008, at https://www.federalreserve.gov/newsevents/speech/mishkin20080515a.htm.

[53] For a study that attempted to measure the "Greenspan put," see Sandeep Dahiya et al., "The Greenspan Put," Working Paper, revised January 10, 2019, at https://papers.ssrn.com/sol3/papers.cfm?abstract_id=2993326.

above speculative grade ("junk"). Firms viewed this as a profitable strategy for keeping their borrowing costs low while taking on greater risk (e.g., by increasing leverage).[54] The Fed chose to make some facilities available to "fallen angels"—firms who have been downgraded to junk since the start of the pandemic, including those who previously had the lowest investment grade. Although those firms could not have been expected to foresee that they would be downgraded because of a pandemic, they were less prudent than more highly-rated firms, yet received the same access to Fed facilities. Because the Fed's response to COVID-19 was more extensive than its previous interventions, it may fuel expectations of similar interventions in the future unless eventually addressed.

Monetary Policy

In contrast with the Fed's emergency facilities where recipients receive direct assistance, the Fed has also used a number of tools to reduce interest rates and promote market liquidity more generally. These tools collectively form its monetary policy. Monetary policy cannot address the root of the problem: economic disruptions caused by the pandemic. But it can ensure that interest rates remain low and liquidity plentiful, so that borrowers—including businesses, households, and the government—can more easily and affordably access credit to cope with the fallout.

Monetary policy is guided by the statutory goals of promoting maximum employment and stable prices. Economic disruptions caused by COVID-19 have pushed unemployment extremely high by historical standards. Meanwhile, prices of goods and services have been falling overall since the pandemic began, meaning that the economy has experienced deflation rather than inflation. In this context, the Fed's mandate called for a more stimulative monetary policy. Given the severity of the downturn, there was greater risk of the Fed doing too little rather than too much. Nevertheless, the Fed's aggressive policy stance may be challenging to unwind when economic conditions eventually normalize.

Actions to Lower Interest Rates

Traditionally, the Fed conducts monetary policy by targeting the *federal funds rate*, the overnight interbank lending rate. During the 2008 financial crisis, the Fed developed two other tools to provide stimulus when short-term rates reached nearly zero—forward guidance and quantitative easing. Both aim to reduce long-term interest rates, which—unlike short-term rates—are not directly determined by the Fed but are important for stimulating economic activity. These tools have been revived in response to COVID-19.

When the Fed lowers the federal funds target, other interest rates tend to fall but on a less than one-to-one basis. Lower interest rates stimulate interest-sensitive spending, such as business capital spending on plant and equipment, household spending on consumer durables, and residential investment. In addition, when interest rates diverge between countries, lower rates cause capital outflows that put downward pressure on the dollar exchange rate, which in turn stimulates spending on exports and imports. (In this case, other countries have also responded to COVID-19 by reducing interest rates, and the dollar exchange rate has remained higher than it was before the pandemic.) Through these channels, monetary policy can be used to stimulate overall spending in the short run.

[54] For more information, see CRS Insight IN11275, *COVID-19 and Corporate Debt Market Stress*, by Eva Su.

Federal Funds Rate

In response to COVID-19, the Fed called two unscheduled meetings of the Federal Open Market Committee in March 2020 to reduce interest rates. On March 3, 2020, the Fed reduced the federal funds rate from a range of 1.5%-1.75% to a range of 1%-1.25% to stimulate economic activity. On March 15, it reduced the range to 0%-0.25%.[55] Economists refer to this as the "zero lower bound" to signify that the Fed's traditional monetary policy tool has been exhausted at this point and cannot be used to provide additional stimulus.[56] This is the second time this interest rate has ever hit the zero lower bound—the first time was during the 2007-2009 financial crisis.

In 2008, Congress granted the Fed the authority in P.L. 110-343 to begin paying interest on reserves that banks hold at the Fed.[57] Since then, the interest rate on reserves has become the primary means by which the Fed targets the federal funds rate, which it does by setting the interest rate on reserves within the federal funds target range. Thus, the Fed has changed this rate when it wants to change the federal funds target range. When the target range was 1.5%-1.75%, the interest rate on reserves was set at 1.6% (0.15 percentage points below the top of the range). When the target range was reduced to 0%-0.25%, the interest rate on reserves was reduced to 0.1%. One option for adding marginally more monetary stimulus would be to reduce the interest rate on reserves to 0%, but this would likely further reduce private activity in the federal funds market, raising questions about its usefulness as a policy target.

Because interest rates were already relatively low in both nominal and inflation-adjusted terms, interest rates did not have far to fall before hitting the zero lower bound, as shown in **Table 3**. As a result, the Fed could not provide much monetary stimulus, even though the economic shock was extremely large (at least in the short term) by historical standards.[58] The Fed quickly turned to forward guidance and quantitative easing to provide more monetary stimulus.

Table 3. Reductions in the Federal Funds Rate

1957-2020

Date of Peak Rate	Peak Rate (Nominal)	Peak Rate (Inflation-Adjusted)	Cumulative Subsequent Reduction in Nominal Rate (Percentage Points)
October 1957	3.5%	0.6%	2.9
February 1960	4.0%	2.6%	2.8
September 1969	9.2%	3.5%	5.5
July 1974	12.9%	1.4%	7.7
April 1980	17.6%	3.0%	4.8
June 1981	19.1%	9.4%	10.4
May 1989	9.8%	4.5%	5.3

[55] Because the federal funds rate is a market rate manipulated by the Fed, market forces cause the actual rate to oscillate within the target range. The Fed sets a 0.25 percentage point range on its federal funds target and uses open market operations to keep the actual rate within the range.

[56] So far, the Fed has not expressed eagerness to implement negative interest rates, as some countries did following the financial crisis. In any case, negative rates have stayed close to zero in these countries.

[57] This authority had been granted in 2006 by P.L. 109-351, but had not been phased in yet. P.L. 110-343 accelerated the phase-in date to the date of its enactment.

[58] See CRS Insight IN11056, *Low Interest Rates, Part 2: Implications for the Federal Reserve*, by Marc Labonte.

Date of Peak Rate	Peak Rate (Nominal)	Peak Rate (Inflation-Adjusted)	Cumulative Subsequent Reduction in Nominal Rate (Percentage Points)
November 2000	6.5%	3.1%	4.8
July 2007	5.3%	2.9%	5.1
July 2019	2.4%	0.6%	2.4

Sources: CRS calculations based on Fed data; David Reifschneider, "Gauging the Ability of the FOMC to Respond to Future Recessions," Federal Reserve, *Finance and Economics Discussion Series 2016-068*, August 2016.

Notes: The federal funds rate was adjusted for inflation using the consumption price index. In early expansions in the table, the federal funds rate was not the explicit target of monetary policy. The table presents the average effective federal funds rate.

Forward Guidance

Forward guidance refers to Fed public communications on its future plans for short-term interest rates, and it took many forms following the 2007-2009 financial crisis. As monetary policy returned to normal in recent years, forward guidance was phased out. It is being used again during COVID-19. For example, when the Fed reduced short-term rates to zero on March 15, 2020, it announced that it "expects to maintain this target range until it is confident that the economy has weathered recent events and is on track to achieve its maximum employment and price stability goals."[59]

The Fed has discussed potentially expanding its use of forward guidance during the pandemic.[60] To date, forward guidance in the pandemic has been less detailed than some of the forward guidance that was used during the 2007-2009 financial crisis, which offered specific dates and economic benchmarks for when policy would be changed in the future. However, unexpected economic developments often derailed these more detailed plans, which may have made the Fed reluctant to use forward guidance again today. For example, in December 2012, the Fed pledged to maintain an "exceptionally low" federal funds target, at least as long as unemployment was above 6.5% and inflation was low. But unemployment then fell faster than the Fed anticipated, given the performance of economic growth and inflation. As a result, when unemployment began approaching 6.5% in March 2014, the Fed did not want to raise rates as it had pledged, so it replaced the 6.5% pledge with vaguer forward guidance: "The Committee currently anticipates that, even after employment and inflation are near mandate-consistent levels, economic conditions may, for some time, warrant keeping the target federal funds rate below levels the Committee views as normal in the longer run."[61]

Forward guidance is generally "just talk" that is not backed by market transactions, such as asset purchases or interventions in credit markets. Nevertheless, proponents argue that forward guidance can lower long-term interest rates by offering a credible pledge that the Fed intends to keep future short-term rates lower (since long-term rates are partly determined by market expectations of future short-term rates). This works only if the pledge is credible to market participants, and the pledge offers lower future short-term rates than participants had already

[59] Federal Reserve, "Federal Reserve issues FOMC statement," press release, March 15, 2020, at https://www.federalreserve.gov/newsevents/pressreleases/monetary20200315a.htm.

[60] Federal Reserve, *Minutes of the Federal Open Market Committee*, April 28-29, 2020, at https://www.federalreserve.gov/monetarypolicy/fomcminutes20200429.htm.

[61] Federal Reserve, "Federal Reserve issues FOMC statement," press release, June 18, 2014, at http://federalreserve.gov/newsevents/press/monetary/20140618a.htm.

expected. The Fed's use of forward guidance can be critiqued on both counts. If it is vague, it may not cause market participants to change their views about future policy. If it is specific, it may no longer be credible because the Fed did not follow through on specific pledges made following the 2007-2009 financial crisis, such as the 6.5% unemployment pledge.

Quantitative Easing

Large-scale asset purchases, popularly referred to as *quantitative easing* (QE), were also used during the 2007-2009 financial crisis. Under QE, the Fed expanded its balance sheet by purchasing long-term Treasury securities, as well as mortgage-backed securities (MBS) and debt issued by government agencies or government-sponsored enterprises. (See the text box above for a discussion of the mechanics of the Fed's balance sheet.) The Fed focused on these types of assets because they posed no credit risk to the Fed (because they were government guaranteed) and because Treasuries and MBS were more liquid than other types of assets, so the short-term impact of large purchases on market conditions would be less disruptive. Three rounds of QE from 2009 to 2014 increased the Fed's securities holdings by $3.7 trillion. The balance sheet was modestly reduced from 2017 to 2019, but it never returned to close to its pre-crisis size.

In theory, the Fed's purchases should increase demand for these securities—thereby reducing their yield—with some spillover effect on other interest rates. Although pinpointing exactly how much QE reduced long-term interest rates is complex and disputed, interest rates were very low by historical standards throughout QE.

On March 15, 2020, the Fed announced it would increase its purchases of Treasury securities and resume its purchases of MBS.[62] By March 17, the Fed's balance sheet had exceeded its post-financial crisis peak of $4.5 trillion. On March 23, the Fed announced it would increase its purchases of Treasury securities and MBS—including commercial MBS—to "the amounts needed to support smooth market functioning and effective transmission of monetary policy."[63] These purchases were undertaken at the unprecedented rate of up to $125 billion daily ($75 billion in Treasuries and $50 billion in MBS) from March 19, 2020, to April 1, 2020, and have continued (but have been gradually tapered down) after that. As a comparison, during the three rounds of QE following the financial crisis, the Fed increased its holdings of securities by an average of about $100 billion, $70 billion, and $80 billion per month, respectively. In April 2020 alone, the Fed's securities holdings increased by about $1.2 trillion.

One notable difference from previous rounds of QE is that the Fed is purchasing securities of different maturities, so the effect likely will not be concentrated on long-term rates.

Policy Issues. Numerous concerns were raised about the 2009-2014 rounds of QE, some of which proved to be unfounded, and some of which are more subjective. Arguably, none of these concerns are significant compared with the economic effects of the pandemic, but they have the potential to become problematic when economic conditions have returned to normal—particularly if QE continues years into the next expansion, as it did last time.

Because QE caused unusually rapid increases in the money supply, many critics claimed in 2009 that QE would cause a spike in the inflation rate. In hindsight, the opposite problem occurred—despite QE, the Fed had chronic problems with inflation running below its target of 2%. While

[62] The Fed had resumed its purchases of Treasury securities on a smaller scale in October 2019 in response to repurchase agreement (repo) market turmoil in September 2019. For more information, see CRS Insight IN11176, *Federal Reserve: Recent Repo Market Intervention*, by Marc Labonte.

[63] Federal Reserve, "Federal Reserve issues FOMC statement," press release, March 23, 2020, at https://www.federalreserve.gov/newsevents/pressreleases/monetary20200323a.htm.

the pandemic lasts, high inflation is unlikely to pose a problem. However, the pace of money supply growth has so far been higher than it was following the financial crisis, and the pandemic has caused consumer hoarding and disruptions to supply chains that have sparked sharp—albeit isolated—price increases in affected goods.

Historically, countries have suffered from hyperinflation when monetary policy becomes subordinated to financing excessive budget deficits. The United States has avoided hyperinflation in modern times by giving the Fed a relatively high degree of political independence and by creating a strict separation between monetary and fiscal policy. This is related to the above concern that both budget deficits and Fed purchases of federal debt are unusually large as a result of the pandemic. The Fed held almost $800 billion of Treasury securities, about 15% of the total publicly held debt at the end of FY2007. That rose to almost $2.5 trillion, a high of 19% of the debt at the end of FY2014. At the end of May 2020, the Fed held $4.1 trillion of Treasury securities, almost 21% of the debt, which could create pressures that weaken the Fed's independence and the separation of monetary and fiscal policy.

A third concern is that QE causes or contributes to asset price bubbles, which pose a threat to financial stability. Critics argue that QE artificially boosts liquidity that then flows into securities markets, such as the stock market, artificially boosting their prices. Deflating asset bubbles featured prominently in both the 2001 and 2007-2009 recessions. Critics also argue that QE contributes to moral hazard and inequality through this effect on asset prices, discussed in the "Policy Issues" section.

A fourth concern is that QE (specifically, MBS purchases) cause distortions in mortgage markets that could reduce economic efficiency. By reducing mortgage yields relative to yields on other types of debt, QE could cause inefficiently high demand for residential housing relative to other interest-sensitive consumer goods or capital investment goods. This concern was particularly salient in the financial crisis because of the role that the housing bubble played in instigating the crisis. On the other hand, the financial crisis also featured a housing crisis, and the Fed's MBS purchases at the time could be justified on the grounds that they helped ameliorate the housing crisis. This justification is less applicable in 2020 since the housing sector has not suffered disproportionately compared with the rest of the economy, at least not to date.

Actions to Provide Overall Market Liquidity

At any given interest rate, the Fed has tools to increase or decrease the overall availability of liquidity in financial markets. In addition to providing liquidity directly through the discount window and emergency facilities in response to COVID-19, the Fed took other actions to boost market liquidity.

Reserve Requirements

On March 15, 2020, the Fed announced that it was reducing reserve requirements—the amount of vault cash or deposits at the Fed that banks must hold against deposits—to zero for the first time ever. Reserve requirements were intended to ensure that banks hold a minimum amount of liquidity, but as a result of the Fed's emergency facilities and securities purchases, bank reserves in excess of reserve requirements have grown by a factor of one thousand since 2008, from less than $2 billion to almost $3 *trillion* in April 2020. (The Fed purchases securities by crediting the reserve accounts of banks.) As the Fed noted in its announcement, because bank reserves are currently so abundant, reserve requirements "do not play a significant role" in monetary policy. Reserve requirements are statutory (12 U.S.C. §461(b)), but statute gives the Fed discretion to set them at any level, including zero.

Reserve requirements do not apply to savings accounts, which are typically differentiated from checking accounts through a monthly six-transaction limit. After the Fed eliminated reserve requirements, it also eliminated the monthly transaction limit on savings accounts, which were never subject to reserve requirements.[64]

Repo Operations

The Fed can temporarily provide liquidity to financial markets by lending cash through repurchase agreements (repos) with primary dealers. From an economic perspective, repos are equivalent to short-term, fully collateralized loans, which expose the Fed to little risk.[65] Before the 2007-2009 financial crisis, repos were the Fed's routine method for targeting the federal funds rate because of the high degree of correlation between repo rates and the federal funds rate. After QE, the Fed's large balance sheet meant repos were no longer needed to target interest rates or provide liquidity (until they were revived in September 2019 in response to a spike in repo rates).[66] However, the Fed has routinely borrowed cash in repo markets (called "reverse repos") since the crisis started to withdraw liquidity from financial markets.

Since March 16, 2020, the Fed has made $1 trillion in overnight repos available at auction every day and has made an additional $500 billion in longer-term repos available at least once a week.[67] (Take-up rates have been significantly lower.) These repos are larger and longer-lasting than those offered since September 2019.

Although the Fed's repo market interventions are not novel, they raise concerns about a lasting impact on a private market—namely, can the Fed reduce its interventions without leading to repo rate instability, or will the Fed's massive repo interventions become permanent?

Foreign Central Bank Swap Lines

Both domestic and foreign commercial banks rely on short-term borrowing markets to access U.S. dollars needed to fund their operations and meet their cash flow needs. But in an environment of strained liquidity, only banks operating in the United States can access the discount window. Therefore, the Fed has standing *swap lines* with major foreign central banks to provide central banks with U.S. dollar funding that these central banks can in turn lend to private banks (without U.S. branches) in their jurisdictions. On March 15, 2020, the Fed reduced the cost of using those swap lines, and on March 19, it extended swap lines to nine more central banks.

On March 31, the Fed created the Foreign and International Monetary Authorities Repo Facility to allow foreign central banks to temporarily swap Treasury securities for U.S. dollars.[68] The Fed

[64] Federal Reserve, "Federal Reserve Board announces interim final rule to delete the six-per-month limit on convenient transfers from the 'savings deposit' definition in Regulation D," press release, April 24, 2020, at https://www.federalreserve.gov/newsevents/pressreleases/bcreg20200424a.htm.

[65] For background on repo markets, see CRS In Focus IF11383, *Repurchase Agreements (Repos): A Primer*, by Marc Labonte.

[66] For more on the Fed's recent monetary policy response, see CRS Insight IN11330, *Federal Reserve: Monetary Policy Actions in Response to COVID-19*, by Marc Labonte.

[67] The Fed's repo operation schedule is available at https://www.newyorkfed.org/markets/domestic-market-operations/monetary-policy-implementation/repo-reverse-repo-agreements/repurchase-agreement-operational-details#monthly-summary.

[68] For more information, see CRS In Focus IF11498, *COVID-19: Federal Reserve Support for Foreign Central Banks*, by Martin A. Weiss, Marc Labonte, and James K. Jackson. See also Nicola Cetorelli, Linda S. Goldberg, and Fabiola Ravazzolo, "Have the Fed Swap Lines Reduced Dollar Funding Strains during the COVID-19 Outbreak?, *Liberty Street Economics*, Federal Reserve Bank of New York, May 22, 2020, at

will charge an interest rate of 0.25 percentage points above the interest rate paid on bank reserves on these repos. The facility is available to a broader group of central banks than the swap lines.

Recent use of the swap lines quickly exceeded use during the 2012 euro crisis and have been at levels comparable to 2008. The rapid uptake in swap lines during the pandemic underlines the world financial system's reliance on U.S. dollars as the world's "reserve currency." On net, this reliance is arguably beneficial to the United States because it allows the United States to finance its large public and private debt at very low interest rates. Further, the dollar's reserve currency status makes U.S. debt financing more dependable, as it would be difficult for foreign investors to reduce their reliance on U.S. dollars to underpin financial arrangements. Thus, the Fed's swap lines reinforce the dollar's reserve currency status.

The liquidity swaps are repaid at the exchange rate prevailing at the time of the original swap, meaning that there is no downside risk for the Fed if the dollar appreciates in the meantime (although the Fed also does not enjoy upside gain if the dollar depreciates). Because the swaps are only with other central banks with the most widely used currencies, there is essentially no credit risk involved (the foreign central bank bears losses if the private bank it lends the dollars to defaults).

Authority Used in the Federal Reserve's COVID-19 Response

A distinction can be drawn between the actions the Fed is authorized to take in normal conditions and the emergency authority it has in "unusual and exigent circumstances." Many actions it has taken in response to the pandemic are based on its normal authority, including its monetary policy actions, discount window lending, repos, and central bank liquidity swaps. The next section briefly describes what assets it is normally authorized to purchase. Two other sets of statutory requirements govern the Fed's emergency facilities, which are described in the two sections that follow.

For more information on the Fed's legal authority, see CRS Legal Sidebar LSB10435, *The Federal Reserve's Legal Authorities for Responding to the Economic Impacts of COVID-19*, by Jay B. Sykes.

Asset Purchases

The types of assets that the Fed may purchase are fairly limited by Section 14 of the Federal Reserve Act (12 U.S.C. §355) and include debt issued or guaranteed by the federal government or federal agencies. For this purpose, "federal agency" has been interpreted to include the government sponsored enterprises, Fannie Mae and Freddie Mac. The Fed may also purchase gold and debt or currency issued by foreign governments. It may purchase debt issued by state and local governments, but only if the debt has a maturity of less than six months and is backed by anticipated taxes or assured revenues.

https://libertystreeteconomics.newyorkfed.org/2020/05/have-fed-swap-lines-reduced-dollar-funding-strains-during-the-covid-19-outbreak.html.

The Fed may purchase any of the assets authorized under Section 14 at any time. Statute places no limit on how many assets the Fed may purchase, so there is no statutory limit to the size of its QE operations or its balance sheet.

In the financial crisis and the pandemic, the Fed has been able to purchase other types of assets that Section 14 does not authorize, including corporate debt and a broader range of municipal debt, through SPVs using Section 13(3).

Section 13(3) of the Federal Reserve Act

All of the Fed's emergency facilities created during the pandemic have been authorized under the Fed's emergency lending authority, Section 13(3) of the Federal Reserve Act. Until the Dodd-Frank Act, this authority was very broad, with few limitations. One pre-crisis limitation was that the authority could be used only in "unusual and exigent circumstances." Concerns in Congress about some of the Fed's actions under Section 13(3) during the financial crisis led to the section's amendment in Section 1101 of the Dodd-Frank Act. Generally, the intention of the provision in the Dodd-Frank Act was to prevent the Fed from rescuing failing firms while preserving enough of its discretion that it could still create broadly based facilities to address unpredictable market-access problems during a crisis.[69] Specifically, the Dodd-Frank Act

- replaced "individual, partnership, or corporation" with "participant in any program or facility with broad-based eligibility" as the eligible recipient;
- required that assistance be "for the purpose of providing liquidity to the financial system, and not to aid a failing financial company." It ruled out lending to an insolvent firm, defined as "in any bankruptcy, resolution, or … insolvency proceeding";
- required that loans be secured "sufficient(ly) to protect taxpayers from losses" and that collateral be assigned a "lendable value" that is "consistent with sound risk management practices";
- forbade "a program or facility that is structured to remove assets from the balance sheet of a single and specific company";
- required any program "to be terminated in a timely and orderly fashion"; and
- required the "prior approval of the Secretary of the Treasury."[70]

The Dodd-Frank Act also required the Fed to promulgate a rule implementing Section 1101 "as soon as is practicable," and the Fed promulgated a final rule on December 18, 2015.[71] In some cases, the final rule goes beyond the statutory requirements. For example, although the statute prohibits only lending to firms that are in a bankruptcy or insolvency proceeding, the final rule also prohibits lending to: any facility, unless it is open to at least five eligible borrowers; any recipient who has not been current on its debt over the past 90 days; a healthy firm for the purposes of preventing a third party from failing (as was the case with JPMorgan Chase and Bear

[69] See, for example, the *Joint Explanatory Statement of the Committee of the Conference to* P.L. 111-203, H.Rept. 111-517, 111th Congress, June 29, 2010.

[70] The Dodd-Frank Act left three requirements in the original statute largely unchanged: (1) a finding of unusual and exigent circumstances; (2) that interest rates be set consistent with statute governing the discount window; and (3) a finding that the borrower be unable to access private credit.

[71] Federal Reserve, "Extensions of Credit by Federal Reserve Banks," 80 *Federal Register* 78959, December 18, 2015, at https://www.gpo.gov/fdsys/pkg/FR-2015-12-18/pdf/2015-30584.pdf.

Stearns); and a firm so that it can avoid bankruptcy or resolution. **Table 4** explains how the final rule implements the major provisions of Section 13(3).

Table 4. Major Provisions of the Federal Reserve's Final Rule Implementing Dodd-Frank Act Changes to Section 13(3)

Section 13(3) Provision	Final Rule Implementation
Limits assistance to any "participant in any program or facility with broad-based eligibility."	Minimum of five eligible participants for a program to meet the "broad-based eligibility" requirement.
Specifies that assistance be "for the purpose of providing liquidity to the financial system, and not to aid a failing financial company." Requires that regulations preclude insolvent borrowers (i.e., borrowers "in bankruptcy, resolution ... or any other Federal or State insolvency proceeding").	Specifies that liquidity may be provided only to an identifiable market or sector of the financial system. Provides that a program may not be used for a firm to avoid bankruptcy or resolution. Specifies that a program designed to aid one or more failing companies or to assist one or more companies to avoid bankruptcy, resolution, or insolvency will not be considered to have the required "broad-based eligibility." Requires borrowers be current on their debt for 90 days before borrowing. Permits the Fed to determine whether the applicant is insolvent. Excludes a firm from borrowing from the Fed if the purpose is to help a third-party firm that is insolvent. Includes immediate repayment and enforcement actions for firms that "make[s] a willful misrepresentation regarding its solvency." Specifies that the Fed is under no obligation to extend credit to a borrower.
Requires that loans be secured "sufficient[ly] to protect taxpayers from losses," and collateral be assigned a "lendable value" that is "consistent with sound risk management practices."	Requires that the Fed assign a lendable value to collateral at the time credit is extended.
Forbids "a program or facility that is structured to remove assets from the balance sheet of a single and specific company."	Prohibits removing assets from one or more firms that meet the rule's definition of failing.
Requires "prior approval of the Secretary of the Treasury."	Specifies that no program may be established without the approval of the Secretary of the Treasury.
Specifies that the authority may be invoked only in "unusual and exigent circumstances" and that any program be "terminated in a timely and orderly fashion."	Requires that the Fed provide "a description of the unusual and exigent circumstances that exist" no later than seven days after establishing a program. Requires that initial credit terminates within one year, with extension possible only upon a vote of five governors and approval by the Secretary of the Treasury. Requires a review of programs every six months to assure timely termination.
Specifies that rates be consistent with the statutory requirements governing the discount rate.[a]	Requires the rate charged must be a *penalty rate*, defined as a rate that is a premium to the market rate in normal circumstances. It must also be a rate that "affords liquidity in unusual and exigent circumstances; and ... encourages repayment of the credit and discourages use of the program" when "economic conditions normalize." Permits the charging of "any fees, penalties ... or other consideration ... to protect and appropriately compensate the taxpayer.... "

Section 13(3) Provision	Final Rule Implementation
Specifies that the borrower must be "unable to secure adequate credit accommodations from other banking institutions."[a]	Requires evidence of inability of participants in a program to obtain credit. The evidence may be based on economic conditions in a particular market or markets; on the borrower's certification of its inability "to secure adequate credit accommodations from other banking institutions"; or on "other evidence from participants or other sources."

Source: CRS, based on Federal Reserve, "Extensions of Credit by Federal Reserve Banks," 80 *Federal Register* 78959, December 18, 2015, available at https://www.gpo.gov/fdsys/pkg/FR-2015-12-18/pdf/2015-30584.pdf.

a. Requirement is largely unchanged by the Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank Act; P.L. 111-203).

CARES Act

In addition to the Section 13(3) restrictions, a subset of emergency facilities have been authorized under the CARES Act. The CARES Act appropriated $500 billion to Treasury's ESF for the Treasury Secretary to provide loans, loan guarantees, and other investments to "eligible businesses, states, and municipalities related to losses incurred as a result of coronavirus.... "[72] Under Section 4029 of the CARES Act, Treasury cannot make new loans, guarantees, and investments after December 31, 2020. Outstanding loans, guarantees, and investments after this date would be allowed to be modified, restructured, or amended, but not forgiven.

Some of the $500 billion is set aside for Treasury to directly assist three industries—up to $25 billion to industries related to passenger air; up to $4 billion to cargo air carriers; and up to $17 billion to businesses critical to national security. The remainder—at least $454 billion—is available for Treasury to make loans, loan guarantees, or investments in programs or facilities established by the Fed to provide liquidity to the financial system by supporting lending to "eligible businesses," "states," and municipalities. The Fed's facilities may purchase obligations in primary or secondary markets or make loans.

The act allows the Treasury Secretary to decide whether and how much of the CARES Act funds to provide to the Fed and on what general terms. The act provides Treasury and the Fed broad discretion how to structure these programs or facilities.

Fed facilities backed by CARES Act funding are subject to terms and conditions found in that act. Fed assistance may go only to U.S. businesses (as defined by the act). Assistance is ineligible for loan forgiveness. Conflict of interest provisions forbid businesses controlled by certain public officials and their relatives from accessing Fed facilities backed by the CARES Act. These facilities are also subject to reporting requirements described in the "CARES Act" section, below.

CARES Act restrictions on executive compensation and capital distributions (stock buybacks and dividends) do not apply to Fed programs unless the Fed is providing direct loans to recipients; in the case of the Fed programs, the Treasury Secretary may waive these requirements "to protect the interests of the Federal Government." To date, these restrictions have been applied only to the MSLP. Likewise, requirements to provide the government with warrants or other forms of compensation do not apply to the Fed programs. Fewer restrictions may have been placed on Fed

[72] "Eligible business" is defined as an air carrier or "U.S. Business that has not otherwise received adequate economic relief." "State" is defined to include the 50 states, Washington DC, U.S. territories and possessions, multistate entities, and Indian tribes.

programs because of the Fed's independence from Congress and the Administration, and because most of the Fed programs are not intended to prevent recipients' imminent failure.[73]

Although all seven of the facilities identified in the "Emergency Facilities" section are backed by the ESF, which facilities the Fed considers to be subject to CARES Act requirements is somewhat ambiguous at this time. The MSLP and MLF were created after the CARES Act's enactment; the other facilities were announced before the CARES Act was enacted. On May 19, 2020, Chair Powell testified that "In connection with the CARES Act facilities—including the two corporate credit facilities, the Main Street Lending Program, the Municipal Liquidity Facility, and the TALF—we will be disclosing … " This statement could indicate that five of the seven ESF-backed facilities are subject to the CARES Act, including three that predate enactment of the CARES Act. The term sheets for the TALF, MLF, and MSLP state that "The Department of the Treasury, using funds appropriated to the Exchange Stabilization Fund under Section 4027 of the Coronavirus Aid, Relief, and Economic Security Act ('CARES Act'), will make an equity investment of … in the SPV."[74] However, similar statements are not found in the terms sheets for the PMCCF or SMCCF. Further, in one of the press releases announcing the disclosures referenced by Chair Powell, the Fed stated that "…. information it will publicly disclose for the TALF and the Paycheck Protection Program Liquidity Facility (PPPLF) on a monthly basis…. The disclosures are similar to those announced in April for the Board facilities that utilize CARES Act funds."[75] This announcement would seem to suggest that the Fed does not consider TALF to be subject to the CARES Act.[76]

Oversight and Disclosure Requirements

Prior to the 2007-2009 financial crisis, the Fed kept information about lending transactions confidential, and Government Accountability Office (GAO) oversight was very limited by statute. (Although there was ongoing use of the discount window, almost no transactions occurred under Section 13(3) between the 1930s and 2008.) A series of acts during the financial crisis, with the Dodd-Frank Act being the most recent and significant, chipped away at Fed confidentiality.[77]

[73] If the Fed were to create the medium-sized business lending program envisioned in Section 4003, additional terms and restrictions would apply to that facility.

[74] Federal Reserve, "Terms Asset-Backed Securities Loan Facility," at https://www.federalreserve.gov/newsevents/pressreleases/files/monetary20200512a1.pdf.

[75] Federal Reserve, "Federal Reserve publishes updates to the term sheet for the Term Asset-Backed Securities Loan Facility (TALF) and announces information to be disclosed monthly for the TALF and the Paycheck Protection Program Liquidity Facility," press release, May 12, 2020, at https://www.federalreserve.gov/newsevents/pressreleases/monetary20200512a.htm.

[76] From a funding perspective, whether a Fed facility is designated as a CARES Act facility matters only if future losses on non-CARES Act facilities were to exceed the $93 billion in assets that the ESF held before enactment of the CARES Act. Alternatively, designating more programs as CARES Act programs would more quickly exhaust the funds provided by the CARES Act; but as **Table 4** demonstrates, there are still unused CARES Act funds available at this time.

[77] Before the Dodd-Frank Act, the Emergency Economic Stabilization Act (P.L. 110-343) required the Fed to report to the congressional committees of jurisdiction, and the Helping Families Save Their Homes Act (P.L. 111-22) provided GAO with oversight of a limited number of Section 13(3) transactions.

Dodd-Frank Act

The Dodd-Frank Act contained a number of forward-looking disclosure provisions that apply to COVID-19-related actions.[78] It required that details on any assistance provided under Section 13(3) be reported to the committees of jurisdiction within seven days, with regular updates.[79] Section 1103 required lending records (including details on the identity of the borrower and the terms of the loan) from future programs created under Section 13(3) to be publicly released a year after the facility was terminated or two years after lending ceased, whichever came first. It also required discount window lending and open market operation records to be publicly released two years after they occur.[80]

The act allowed GAO to audit any action under Section 13(3) for operational integrity, accounting, financial reporting, internal controls, effectiveness of collateral policies, favoritism, and use of third-party contractors—but did not allow GAO to conduct an economic evaluation of those actions. GAO may not disclose confidential information until the lending records are released.

The act also required the Fed to provide the congressional committees of jurisdiction with details of all transactions, including amounts and the identities of borrowers, within seven days of the program's creation and with updates every 30 days thereafter. In addition, the Dodd-Frank Act requires transaction details to be publicly disclosed one year after the facility is closed.[81]

CARES Act

For Fed programs that are backed by CARES Act funding, oversight and disclosure provisions of the CARES Act apply. The CARES Act provides three main types of oversight, through the creation of a special inspector general and a Congressional Oversight Commission and the imposition of various reporting requirements.[82]

- Section 4018 creates a Special Inspector General for Pandemic Recovery, appointed by the President and confirmed by the Senate. The inspector general is to provide oversight of loans, loan guarantees, and other investments made by the Treasury Secretary, including in Fed emergency programs. It is unclear to what extent this oversight of Treasury's support of Fed programs extends to the programs themselves and the Fed's actions surrounding them.
- Section 4020 creates a Congressional Oversight Commission appointed by congressional leadership. The powers of the commission more explicitly include oversight of the Fed's actions under CARES Act authority.
- Section 4026 extends the Dodd-Frank Act reporting requirements applying to Section 13(3) transactions to all Fed transactions backed by CARES Act. It requires the Fed Chair and Treasury Secretary to testify quarterly before the committees of jurisdiction. It also requires GAO to conduct annual studies of the

[78] It also included backward-looking provisions that applied to actions taken during the financial crisis.

[79] For COVID-19 facilities, these reports can be accessed at https://www.federalreserve.gov/reports-to-congress-covid-19.htm.

[80] These records can be accessed at https://www.federalreserve.gov/regreform/reform-quarterly-transaction.htm.

[81] Transaction data are posted at https://www.federalreserve.gov/newsevents/reform_transaction.htm.

[82] For more information, see CRS Report R46329, *Treasury and Federal Reserve Financial Assistance in Title IV of the CARES Act (P.L. 116-136)*, coordinated by Andrew P. Scott; CRS Insight IN11328, *Special Inspector General for Pandemic Recovery: Responsibilities, Authority, and Appointment*, by Ben Wilhelm; and CRS Insight IN11304, *COVID-19 Congressional Oversight Commission (COC)*, by Jacob R. Straus and William T. Egar.

loans, loan guarantees, and other investments made by the Treasury Secretary, including in Fed emergency programs. The inspector general and Congressional Oversight Commission are also responsible for providing reports to Congress on the uses of CARES Act funding.

Federal Reserve Provisions in the HEROES Act (H.R. 6800)

On May 15, 2020, the House passed the HEROES Act (H.R. 6800), a wide-ranging COVID-19 relief bill. The HEROES Act would expand the government's assistance, in part, by providing the Fed with new authority and mandates in an effort to further expand its lender-of-last-resort role to additional entities. H.R. 6800 has been referred to the Senate.

Facilities for Creditors. Three provisions of the HEROES Act would provide assistance for creditors providing forbearance, depending on the type of loan:

- Section 110404 would require the Fed to create a facility backed by CARES Act funds that provides long-term, low-cost loans to creditors and debt collectors who have losses caused by offering loan forbearance to consumers and who participate in the forbearance program established in Section 110403. Payments on these loans would be deferred until borrowers resume repayment, as required by the bill. Eligibility would include private creditors and debt collectors of most types of consumer debt (except federally-backed mortgages).
- Section 110603 would require the Fed to create a similar facility for creditors and debt collectors participating in the forbearance program established by Section 110602 for loans to small businesses and nonprofits (as defined by the bill).
- Section 110204 would require the Treasury Secretary to ensure that servicers of federally-backed mortgages can participate in Fed programs backed by CARES Act funds, as long as Fed assistance is used for borrower assistance (e.g., loss mitigation and forbearance), among other requirements.

Facility for Landlords. Section 110204 also would require the Fed to create an emergency facility backed by CARES Act funds to provide long-term, low-cost loans to residential rental property owners to temporarily compensate them for losses caused by reductions in rent payments. Loan payments would be deferred for six months. Property owners could not evict tenants or charge late fees and penalties for unpaid rent, as long as the loan was outstanding.

Municipal Debt. As detailed earlier, the securities the Fed is authorized to purchase directly are limited. For municipal debt, it can only purchase debt that has a maturity of less than six months and is backed by anticipated taxes or assured revenues. The Fed has not purchased municipal debt directly since the 1930s. Section 110801 of the HEROES Act would remove these restrictions and make debt issued by the District of Columbia, U.S. territories, and "federally recognized Indian tribe(s)" eligible for purchase in "unusual and exigent circumstances."

Section 110801 also would make changes to MLF terms, including extending its expiration date to the end of 2021; extending the maturity of eligible debt to 10 years; setting the implicit yield on debt purchased equal to the Fed's discount rate; making debt of U.S. territories eligible; and reducing the minimum eligible population size for an issuer to 50,000.

Main Street Lending Program. Section 110604 of the HEROES Act would require the Fed to make nonprofits eligible for the MSLP and allow certain nonprofits serving low-income

communities to have these loans forgiven by Treasury. Section 110605 would require the Fed to offer an MSLP program for small businesses, smaller institutions of higher education, and nonprofits without a minimum loan size.

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