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

Updated February 8, 2021

Congressional Research Service
https://crsreports.congress.gov
R46411

CRS REPORT
Prepared for Members and
Committees of Congress

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SUMMARY

R46411

February 8, 2021

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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) took multiple policy actions in response to the crisis, and Congress took 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 (CARES Act; P.L. 116-136).

The Fed acted to promote economic and financial stability in both its monetary policy and its *lender of last resort* roles. Some of these actions were intended to stimulate economic activity by reducing interest rates, and others were intended to provide liquidity so firms have access to needed funding. The Fed acted 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 U.S. dollars so that the central banks can lend those dollars to banks in their jurisdictions. Swaps outstanding peaked at nearly $450 billion in May 2020 but have been below $100 billion since August 2020.

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 a Main Street Lending Program for mid-size businesses and nonprofits. 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 charged 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. Assistance outstanding under these facilities peaked at nearly $200 billion in April 2020 but hovered around $100 billion for the rest of the year. Treasury 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, were much lower and have been zero since June 2020.

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%. 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. Its 2020 purchases were 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 previous all-time high ($4.5 trillion) by March 2020 and exceeded $7 trillion by May 2020. The Fed has pledged that it will not raise interest rates until the economy has reached full employment and consistently maintained 2% inflation and that it will continue large-scale asset purchases until "substantial further progress" has been made toward those goals.

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 Administration and Congress, 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. 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.

The emergency programs backed by the CARES Act expired at the end of 2020, while most other emergency programs were extended until March 2021. With the pandemic worsening in the winter of 2020, Congress debated whether the CARES Act programs should be extended. P.L. 116-260 prohibited the Fed from reopening CARES Act programs for corporate bonds, municipal debt, and the Main Street Lending Program.

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Economic Context and Overview

The Coronavirus Disease 2019 (COVID-19) pandemic caused unprecedented disruptions to the economy in spring 2020.[1] Business closures and other disruptions to economic activity caused bankruptcies, high unemployment, and loss of income.

In addition to the disruption to economic activity, the pandemic initially caused a sharp decline in prices and private liquidity in financial markets and an increase in volatility that threatened to spark a financial crisis.[2] A financial crisis would be expected to amplify the economic downturn by disrupting the functioning of the financial system and making credit less available to borrowers.

Economic stimulus and financial stabilization policies in response to COVID-19 have been initiated by Congress through a series of fiscal stimulus and relief packages and by the Federal Reserve through a series of monetary stimulus and emergency lending initiatives. Most economists believe that the fiscal and monetary policy response prevented the pandemic from causing a financial crisis and a much deeper and more prolonged recession.

Economic activity rebounded strongly in fall 2020, but overall employment and projected output remained well below its pre-pandemic level at the end of 2020. A full economic recovery is unlikely to occur until the public health situation has normalized so that people are willing to fully resume economic activity that is incompatible with social distancing. The recovery in financial markets was more pronounced. Stock market indices trended upward beginning in April 2020 and surpassed pre-pandemic levels by August. Corporate bond market issuance reached a record high in 2020, and municipal bond issuance was the highest in a decade amidst historically low interest rates.[3] However, bank business lending standards tightened, lending to subprime households fell, and fewer consumers applied for credit cards and auto loans.[4]

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.[5] 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 under emergency authority found in Section 13(3) of the Federal Reserve Act

[1] See CRS Report R46606, *COVID-19 and the U.S. Economy*, by Lida R. Weinstock.

[2] See Federal Reserve, *Financial Stability Report*, May 2020, at https://www.federalreserve.gov/publications/2020-may-financial-stability-report-purpose.htm; Financial Stability Oversight Council, *Annual Report*, December 2020, at https://home.treasury.gov/system/files/261/FSOC2020AnnualReport.pdf.

[3] See, for example, Joe Rennison, "U.S. Corporate Bond Issuance Hits $1.919tn in 2020, Beating Full-Year Record," *Financial Times*, September 2, 2020, at https://www.ft.com/content/a59c2a9d-5e0b-4cbc-b69e-a138de76a776. Heather Gillers, "Covid-19 Pandemic Drives Municipal Borrowing to 10-Year High," *Wall Street Journal*, January 12, 2021, at https://www.wsj.com/articles/covid-19-pandemic-drives-municipal-borrowing-to-10-year-high-11610447402.

[4] Scott Fulford, Christa Gibbs, and Éva Nagypál, "Credit Applications Remain Depressed for Credit Cards and Auto Loans," Consumer Financial Protection Bureau, December 23, 2020, at https://www.consumerfinance.gov/about-us/blog/credit-applications-remain-depressed-for-credit-cards-and-auto-loans/; Federal Reserve, "Senior Loan Officer Opinion Survey on Bank Lending Practices," October 2020, at https://www.federalreserve.gov/data/sloos/sloos-202010-table2.htm; Federal Reserve, *Financial Stability Report*, November 2020, at https://www.federalreserve.gov/publications/2020-november-financial-stability-report-borrowing.htm.

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

(12 U.S.C. §343).[6] The Fed's primary responsibility in modern times is monetary policy, which it carries out under normal conditions by targeting short-term interest rates.[7]

In response to COVID-19, the Fed has taken a number of steps to promote economic and financial stability involving its roles in monetary policy and as lender of last resort. 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 a series of emergency facilities, going further than it did in the 2007-2009 financial crisis to provide credit to nonfinancial businesses and states and municipalities. It has also provided liquidity to markets more broadly. The Fed has also taken actions in its role as a bank regulator, which are not covered in this report (see CRS Report R46422, *COVID-19 and the Banking Industry: Risks and Policy Responses*, coordinated by David W. Perkins).

The Fed's powers were granted by Congress, which retains oversight responsibilities for the Fed's actions. Congress has debated whether the Fed's role should be extended or reined in during the pandemic.[8] In addition to actions the Fed has taken under existing authority, Congress has passed wide-ranging relief legislation in response to the crisis, which 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), available until the end of 2020, to support the Fed's emergency facilities. Enacted in December 2020, the Consolidated Appropriations Act, 2021 (P.L. 116-260), prohibited the Fed from reopening CARES Act programs for corporate bonds, municipal debt, and the Main Street Lending Program. 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.

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. It then provides a brief discussion of the statutory restrictions and oversight of the Fed's actions.

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.

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

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

[8] For example, on May 15, 2020, the House passed the Heroes Act (H.R. 6800 in the 116th Congress), which would have further extended the Fed's emergency facilities to additional classes of borrowers. Similar provisions were included in the "second" Heroes Act (H.R. 925 in the 116th Congress), which the House passed on October 1, 2020.

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.[9] 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,[10] 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 surged in March. This surge coincided with an increase in short-term bank borrowing in private markets, as banks shored up their liquidity in response to the crisis.[11] It peaked at $51 billion on March 25, 2020. It fell sharply throughout the late spring and summer but remained above normal levels throughout 2020. More than 900 banks borrowed from the discount window in the first six months of the pandemic.[12]

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 from the Fed when their reserve 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.[13]

Emergency Facilities

In response to the financial disruption caused by COVID-19, the Fed extended its lender of last resort role beyond the banking system to assist nonbank firms and nonbank financial markets. In 2020, the Fed created nine temporary emergency programs in response to COVID-19.[14] The first wave of Fed programs was announced in March in an attempt to stabilize overall financial market conditions, which experienced illiquidity at the onset of the pandemic. The facilities became operational between March 20 and April 14, and their usage fell off quickly in the late spring. These facilities were focused on shorter-term credit markets. Later programs were focused on longer-term credit markets, including consumer credit, corporate and municipal bonds, and loans for businesses that were harmed by the economic disruption caused by COVID-19. These

[9] 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.

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

[11] See Federal Reserve Bank of New York data on overnight bank funding volume at https://apps.newyorkfed.org/markets/autorates/obfr.

[12] Federal Reserve, "Quarterly Report on Federal Reserve Balance Sheet Developments," August 2020, at https://www.federalreserve.gov/monetarypolicy/quarterly-balance-sheet-developments-report.htm.

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

[14] The Main Street Lending Program was composed of five separate but related facilities, which are not counted separately here.

programs became operational between April 16 and September 4, and usage gradually ramped up.[15]

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. And 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.[16] The facilities discussed in this section were all created under the Fed's emergency lending authority, found in Section 13(3) of the Federal Reserve Act, and some were backed by the ESF.[17]

Five of these programs were backed by CARES Act funds (via the ESF):[18]

- **Primary Market Corporate Credit Facility (PMCCF) and Secondary Market Corporate Credit Facility (SMCCF).** In response to reduced liquidity in the corporate bond market in the spring, the Fed created two new facilities—(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.[19] 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.[20] The facilities closed at the end of 2020. The PMCCF was never used.[21] When the SMCCF closed, it had assistance of $14.1 billion outstanding and had purchased over 1,300 bonds and bond ETFs. At that time, more than half of the bonds held had the lowest investment grade, and about 3% were rated high yield ("junk").[22]

[15] Operational dates from GAO, Federal Reserve Lending Programs: Use of CARES Act-Supported Programs Has Been Limited and Flow of Credit Has Generally Improved, GAO-21-180, December 10, 2020, https://www.gao.gov/assets/720/711141.pdf.

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

[17] Section 13(3) is codified at Title 12, Section 343, of the *United States Code*. For more detail, see the section below entitled "Section 13(3) of the Federal Reserve Act."

[18] 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.

[19] 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").

[20] 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; and Nina Boyarchenko, Anna Kovner, and Or Shachar, "The Impact of the Corporate Credit Facilities," *Liberty Street Economics*, Federal Reserve Bank of New York, October 1, 2020, https://libertystreeteconomics.newyorkfed.org/2020/10/the-impact-of-the-corporate-credit-facilities.html.

[21] Federal Reserve, Periodic Report: Update on Outstanding Lending Facilities Authorized by the Board Under Section 13(3) of the Federal Reserve Act, January 9, 2021, at https://www.federalreserve.gov/publications/files/pdcf-mmlf-cpff-pmccf-smccf-talf-mlf-ppplf-msnlf-mself-msplf-nonlf-noelf-01-11-21.pdf.

[22] Transaction data posted at https://www.federalreserve.gov/reports-to-congress-covid-19.htm.

- **Term Asset-Backed Securities Loan Facility (TALF).** In response to a 70% decline in the issuance of private asset-backed securities (ABS) between February and April 2020,[23] the TALF made nonrecourse, three-year loans to private investors to purchase newly issued, highly rated ABS backed by various types of loans other than residential mortgages.[24] Eligible ABS included 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.[25] The facility closed at the end of 2020. In total, TALF lent $4.1 billion to investors to purchase over 250 ABS.[26]
- **Main Street Lending Program (MSLP).** The MSLP bought new or expanded loans from depository institutions that are five-year loans to businesses and nonprofits with up to 15,000 employees or up to $5 billion in revenues. It was composed of five facilities, depending on the type of loan and borrower. The loans must defer principal for two years and interest repayment for one year, and borrowers have to make a "reasonable effort" to retain employees. Thus, the program was targeted specifically to lend to businesses that had temporary disruptions to revenues. This program may have been particularly attractive to businesses too large to qualify for SBA assistance, such as the Paycheck Protection Program.[27] The facilities closed on January 8, 2021, but did not purchase loans that were submitted after December 14, 2020. The MSLP extended $16.5 billion to purchase about 1,800 loans, of which 15 were to nonprofits.[28] Most loans were made to businesses rather than nonprofits.[29]
- **Municipal Liquidity Facility (MLF).** The MLF purchased shorter-term state and municipal debt in response to higher yields and reduced liquidity in that market in the spring.[30] The facility purchased only debt issued in anticipation of

[23] Elizabeth Caviness and Asani Sarkar, "Securing Secured Finance: The Term Asset-Backed Securities Loan Facility," *Liberty Street Economics*, Federal Reserve Bank of New York, August 07, 2020, at https://libertystreeteconomics.newyorkfed.org/2020/08/securing-secured-finance-the-term-asset-backed-securities-loan-facility.html. 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.

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

[25] 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.

[26] Transaction data posted at https://www.federalreserve.gov/reports-to-congress-covid-19.htm.

[27] For more information, see CRS In Focus IF11632, *The Federal Reserve's Main Street Lending Program*, by Marc Labonte and Lida R. Weinstock. Official resources and reports on the 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. A survey on banks' decisions whether to use the MSLP is available in Federal Reserve, Senior Loan Officer Opinion Survey on Bank Lending Practices, September 2020, at https://www.federalreserve.gov/data/sloos/sloos-202009.htm.

[28] Eric S. Rosengren, "The Economic Outlook—Optimism Despite the Challenges Ahead," speech, January 12, 2021, at https://www.bostonfed.org/news-and-events/speeches/2021/the-economic-outlook-optimism-despite-the-challenges-ahead.aspx.

[29] Federal Reserve, Periodic Report: Update on Outstanding Lending Facilities Authorized by the Board Under Section 13(3) of the Federal Reserve Act, January 9, 2021, at https://www.federalreserve.gov/publications/files/pdcf-mmlf-cpff-pmccf-smccf-talf-mlf-ppplf-msnlf-mself-msplf-nonlf-noelf-01-11-21.pdf.

[30] 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

taxes or dedicated revenues of states, the District of Columbia, 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 met the minimum population limit could designate any combination of their two largest counties or cities to participate.[31] The facility closed at the end of 2020 with $6.4 billion in assistance outstanding. The MLF purchased a total of four bonds from two issuers (the State of Illinois and the Metropolitan Transit Authority of New York).[32]

Two of these programs are backed by non–CARES Act funds from the ESF:

- **Money Market Mutual Fund Liquidity Facility (MMLF).** The MMLF makes nonrecourse loans to financial institutions to purchase assets that money market funds are selling to meet redemptions (withdrawals by account holders).[33] This reduces the probability of runs on money market funds caused by a fund's inability to liquidate assets.[34] The Fed was concerned that unusually large redemptions by fund holders in March 2020 could spiral into a run. In the first week of operation, 568 loans were made to meet redemptions at 102 money market funds. No new loans were made after April 23, but some existing loans remained outstanding at the end of 2020.[35] At its peak in April 2020, the Fed had $53.2 billion in assistance outstanding. On March 19, 2020, the banking regulators issued an interim final rule so that these loans would not affect the borrowing bank's compliance with regulatory capital requirements.[36] The facility

https://libertystreeteconomics.newyorkfed.org/2020/04/helping-state-and-local-governments-stay-liquid.html; Marco Cipriani et al, "Municipal Debt Markets and the COVID-19 Pandemic," *Liberty Street Economics*, Federal Reserve Bank of New York, June 29, 2020, at https://libertystreeteconomics.newyorkfed.org/2020/06/municipal-debt-markets-and-the-covid-19-pandemic.html.

[31] For more information, see CRS In Focus IF11621, *COVID-19: The Federal Reserve's Municipal Liquidity Facility*, by Grant A. Driessen and Marc Labonte. 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.

[32] Transaction data posted at https://www.federalreserve.gov/reports-to-congress-covid-19.htm.

[33] 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.

[34] Official resources and reports on the MMLF are available at https://www.federalreserve.gov/monetarypolicy/mmlf.htm and https://www.bostonfed.org/supervision-and-regulation/supervision/special-facilities/money-market-mutual-fund-liquidity-facility.aspx. For more on money market mutual funds, see Marco Cipriani, Gabriele La Spada, Reed Orchinik, and Aaron Plesset, "The Money Market Mutual Fund Liquidity Facility," *Liberty Street Economics*, Federal Reserve Bank of New York, May 08, 2020, at https://libertystreeteconomics.newyorkfed.org/2020/05/the-money-market-mutual-fund-liquidity-facility.html; and CRS In Focus IF11320, *Money Market Mutual Funds: A Financial Stability Case Study*, by Eva Su.

[35] Federal Reserve, "Quarterly Report on Federal Reserve Balance Sheet Developments," August 2020, at https://www.federalreserve.gov/monetarypolicy/quarterly-balance-sheet-developments-report.htm.

[36] 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.

was extended and is currently scheduled to expire at the end of March 2021. Transaction-level records for this facility are not yet available.

- **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.[37] *Commercial paper* is short-term debt issued by financial firms (including banks), nonfinancial firms, municipalities, and "asset backed" pass-through entities that purchase loans.[38] Money market funds are a large purchaser of commercial paper and had cut back on their purchases when they faced large redemptions in March 2020. The CPFF gave issuers an alternative buyer. At its peak in June 2020, the facility had $4.3 billion in assistance outstanding. The facility has not purchased new commercial paper since mid-July and has had no assistance outstanding since October 14, 2020.[39] The facility was extended and is currently scheduled to expire at the end of March 2021. Transaction-level records for this facility are not yet available.

Two other emergency programs are not backed by the ESF:

- **Primary Dealer Credit Facility (PDCF).** The PDCF provides liquidity to primary dealers,[40] 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.[41] 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 fully collateralized loans to primary dealers for up to 90 days at the discount rate.[42] At its peak in April 2020, the facility had $33.4 billion in assistance outstanding. The facility was extended and is currently scheduled to expire at the end of March 2021. Although this facility was not backed by ESF funding, it is less risky than some of the others, because loans are overcollateralized and made with recourse. Transaction-level records for this facility are not yet available.

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[37] 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.

[38] 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.

[39] Federal Reserve, "Quarterly Report on Federal Reserve Balance Sheet Developments," August 2020, at https://www.federalreserve.gov/monetarypolicy/quarterly-balance-sheet-developments-report.htm.

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

[41] 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.

[42] 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.

- **Paycheck Protection Program Lending Facility (PPPLF).** The PPPLF provides credit to financial institutions making loans under the CARES Act's PPP.[43] Because banks are not required to hold capital against these loans, this facility increases lending capacity for financial institutions facing high demand to originate these loans. The PPP provides low-cost loans to small businesses to pay employees. Although this facility was not backed by ESF funding, these loans do not pose credit risk to the Fed because they are guaranteed by the SBA.[44] The facility was extended and is currently scheduled to expire at the end of March 2021. At its peak, assistance outstanding equaled $70.8 billion. At its peak usage, the facility made over 10,500 loans to about 650 banks, 95% of which were community banks.[45]

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 Fed finances its emergency facilities, securities purchases, repurchase agreements, and other 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, and $7.4 trillion at the end of 2020.[46] 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 and credits them to banks' reserve accounts at the Fed, which flow through banks to recipients or sellers, respectively. In addition to a large increase in bank reserves over this period, the other liability on the Fed's balance sheet to increase significantly was Treasury's cash balances held at the Fed.

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 this is generally the case, the COVID-19 response will reduce the federal budget deficit unless losses on these programs and securities are large. In 2020, the Fed's remittances rose to $88.5 billion from $54.9 billion in 2019. The Fed earned income of $405 million on facilities created in response to COVID-19.[47] Following a similar

[43] 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.

[44] Official resources and reports on the PPPLF are available at https://www.federalreserve.gov/monetarypolicy/ppplf.htm, https://www.bostonfed.org/news-and-events/news/2020/04/paycheck-protection-program-liquidity-facility-ppplf.aspx, and https://www.frbdiscountwindow.org/generalpages/emergency%20credit%202020. See also Haoyang Liu 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.

[45] Transaction data posted at https://www.federalreserve.gov/reports-to-congress-covid-19.htm.

[46] 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/.

[47] Federal Reserve "Federal Reserve Board Announces Reserve Bank Income and Expense Data and Transfers to the Treasury for 2020," press release, January 11, 2021, at https://www.federalreserve.gov/newsevents/pressreleases/other20210111a.htm.

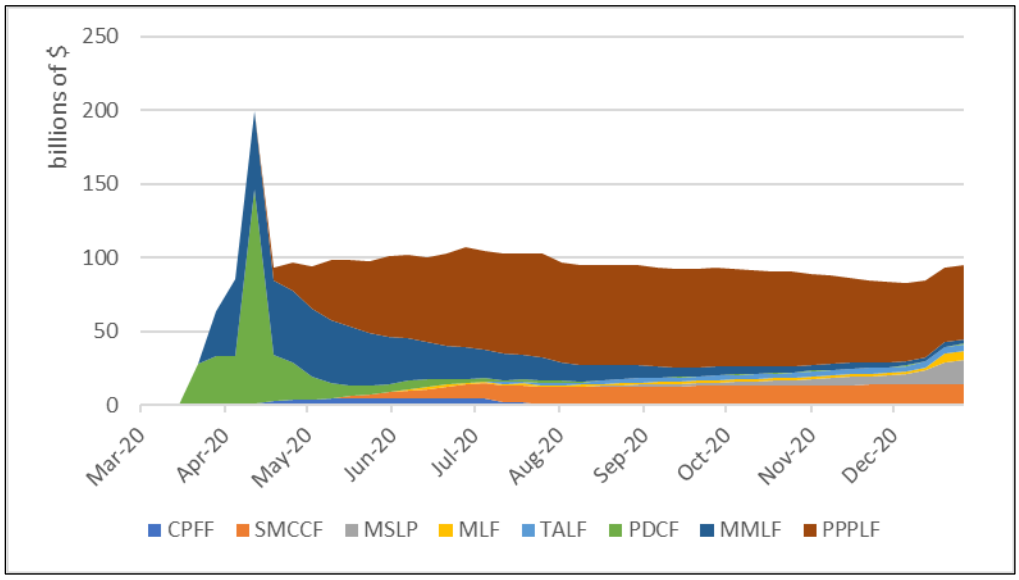
expansion in the Fed's balance sheet during the 2007-2009 financial crisis, the Fed's remittances to Treasury rose from $35 billion in 2007 to more than $75 billion annually from 2010 to 2017.

Program Size

Fed assistance outstanding under 13(3) programs peaked at about $197 billion on April 15, 2020, as shown in **Figure 1**. Three programs (the CPFF, PDCF, and MMLF) were operational at that point and accounted for the entire amount outstanding. Within one week, outstanding assistance under those facilities had more than halved. Outstanding assistance under all of the facilities hovered around $100 billion for the rest of 2020 as use of those three facilities fell while the use of the other facilities rose. This does not represent the "cost" to the Fed or taxpayers; it represents the peak amount that was extended.

Figure 1. Fed Assistance Outstanding in 13(3) Facilities

3/1/20-12/31/20



Source: CRS calculations based on Federal Reserve, "Factors Affecting Reserve Balances—H.4.1," data release, various dates, https://www.federalreserve.gov/releases/h41/.

Notes: Treasury investments in facilities are netted out. See text for details.

The Fed had discretion to set overall size limits, if any, on these facilities. The programs backed by CARES Act funding were announced with an overall size limit. **Table 1** summarizes the size limit of facilities, the actual use of the facilities at their peak and at the end of 2020, and how much ESF funding has been pledged to each facility. In total, $215 billion was pledged.[48] Usage of the facilities turned out to be low compared to their potential size, so less ESF funding was needed than originally pledged. As a result, Treasury and the Fed reduced ESF backing of the facilities to $52.8 billion in January 2021, as discussed in the section below entitled "Winding Down CARES Act Programs and P.L. 116-260."

[48] For most Fed programs backed by the ESF, Treasury and the Fed agreed to invest the ESF funding in two tranches as program use increased. Because the Fed programs remained small relative to pledged funding, the second tranche was never invested. Thus, the actual ESF investment in Fed programs was $114 billion before the January 2021 reduction, compared to the $215 billion pledged.

There are at least two possible explanations for the lack of uptake. First, financial conditions, which were highly unstable early in the pandemic, normalized shortly after the CARES Act was enacted and the Fed programs were announced. Programs that might have been highly subscribed if financial instability persisted were less needed or desired once financial conditions normalized. Second, the terms and conditions of the Fed's programs were not as attractive as comparable sources of private credit despite repeated modifications by the Fed to make them more attractive.[49] These explanations are not mutually exclusive, because those private sources of credit might not have been available (at least on similar terms) if financial conditions had not normalized.

Table 1. Federal Reserve COVID-19 Emergency Programs

billions of dollars, as of January 13, 2021

	Federal Reserve Funds			Exchange Stabilization Fund	
	Announced Size Limit	**Outstanding End of 2020**	**Peak Outstanding[a]**	**Funds Pledged Initially**	**Funds Invested After 2021 Reduction**
	13(3) Facilities Not Backed by CARES Act [b]				
Commercial Paper Funding Facility	n/a	$0	$4.3 on June 10	$10	$10
Primary Dealer Credit Facility	n/a	$0.5	$33.4 on Apr. 15	$0	$0
Money Market Fund Liquidity Facility	n/a	$3.7	$53.2 on Apr. 8	$10	$1.5
Paycheck Protection Program Lending Facility	n/a [c]	$50.4	$70.8 on July 29	$0	$0
Subtotal	**n/a**	**$54.6**	**n/a**	**$20**	**$11.5**
	13(3) Facilities Backed by CARES Act [b]				
Primary Market Corporate Credit Facility/Secondary Market Corporate Credit Facility	$750	$14.1[e]	$14.1 on Jan. 6, 2021[e]	$75	$13.9
Term Asset-Backed Securities Loan Facility	$100	$3.7	$4.1 on Dec. 23	$10	$3.5
Main Street Lending Program[d]	$600	$16.5	$16.6 on Jan. 13, 2021	$75	$16.6
Municipal Liquidity Facility	$500	$6.4	$6.4 on Dec. 30	$35	$6.3
Subtotal	**$1,950**	**$40.7**	**n/a**	**$195**	**$40.3**
Combined Total	**$2,150**	**$95.3**	**n/a**	**$215**	**$51.8**

Source: CRS, based on various Federal Reserve publications.

Notes: Table includes emergency facilities created in 2020 under Section 13(3) of the Federal Reserve Act.

[49] Rosengren discusses how the MSLP could have been made more attractive to borrowers and lenders in Rosengren, "The Economic Outlook—Optimism Despite the Challenges Ahead."

a. Peak outstanding is based on a CRS analysis of weekly totals since March for Wednesdays reported in Federal Reserve, "Factors Affecting Reserve Balances—H.4.1," various dates, data release, https://www.federalreserve.gov/releases/h41/. Facilities identified as backed by CARES Act funding in U.S. Treasury, *Exchange Stabilization Fund Statement of Financial Position*, July 31, 2020, footnote 2, https://home.treasury.gov/system/files/206/ESF_July_Trunc_Footnotes-82720.pdf.

b. Facilities identified as backed by CARES Act funding in U.S. Treasury, *Exchange Stabilization Fund Statement of Financial Position*, July 31, 2020, footnote 2, https://home.treasury.gov/system/files/206/ESF_July_Trunc_Footnotes-82720.pdf.

c. Although the Paycheck Protection Program has a statutory size limit, the Fed's lending facility does not.

d. There are five facilities under the Main Street Lending Program—the Main Street New Loan Facility, the Main Street Priority Loan Facility, the Main Street Expanded Loan Facility, the Nonprofit Organization New Loan Facility, and the Nonprofit Organization Expanded Loan Facility.

e. All assistance was through the Secondary Market Corporate Credit Facility.

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 revived 2008 facilities, with some modifications to the terms of the facilities.[50] The PMCCF, SMCCF, MSLP, MLF, and PPPLF were new and went beyond the scope of the 2008 facilities by purchasing loans of nonfinancial businesses and debt of states and municipalities.

Credit outstanding under Section 13(3) peaked at $710 billion, compared to $197 billion in 2020.[51] 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.[52] 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 indicates that any losses (or profits) will be significantly smaller than the amount outstanding.

Use of Exchange Stabilization Fund to Backstop Potential Losses

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 that would help offset potential losses. Treasury has pledged ESF funds, which were augmented by the CARES Act, for most of these facilities to further protect the Fed from future losses—although these losses would still be borne by the federal government. 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.[53]

[50] The MMLF is 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.

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

[52] Federal Reserve, *Purposes and Functions*, 2020, p. 47, at https://www.federalreserve.gov/aboutthefed/files/pf_3.pdf.

[53] The ESF was not used to backstop 13(3) programs in 2008, but some programs were backed by other Treasury funds. For example, Treasury used funds from Treasury's Troubled Asset Relief Program (TARP) to back TALF in 2009. Similarly, Treasury's investment in TALF was gradually reduced when it became clear it would not be needed, and Congress rescinded some TARP funding as a budgetary offset for the Dodd-Frank Act (P.L. 111-203).

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 ESF funds to make an equity investment in the facility, with funds raised by liquidating existing ESF assets or CARES Act funding, depending on the facility.[54] Future net losses on the facility would reduce Treasury's equity position. When all of the SPV holdings have eventually matured or been sold, the ESF funding plus Treasury's share of the income and profits minus any losses are to be returned to the Treasury.

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. 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) to purchase securities. 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.

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.

Winding Down CARES Act Programs and P.L. 116-260

Under the CARES Act, the Treasury Secretary cannot make any new investments in Fed programs using CARES Act funding after the end of 2020.[55] Given that the pandemic was ongoing and worsening at the end of 2020, Members of Congress debated whether this deadline should be changed, whether Fed programs backed by CARES funds should be extended after the end of the year, and whether the permitted uses of Title IV funds after 2020 should be modified. Ultimately, the CARES Act programs were terminated through a decision by then-Treasury Secretary Steve Mnuchin and the enactment of P.L. 116-260.

Some Members argued that the Fed programs should not be extended on the grounds that financial stability has been restored, and if Fed emergency facilities are extended too long, they may crowd out private credit.[56] To that end, these Members also wanted to withdraw CARES funds pledged to Fed programs that were no longer needed. Other Members supported extending the programs because they thought it was premature to terminate the Fed's facilities when the pandemic was worsening, which could potentially cause economic conditions to deteriorate in

[54] In the case of the MMLF, the funding is provided as credit protection instead of an equity investment in a Fed SPV.

[55] 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.

[56] See, for example, Senate Committee on Banking, Housing, and Urban Affairs, "Crapo Statement at CARES Act Oversight Hearing," press release, December 1, 2020, https://www.banking.senate.gov/newsroom/majority/crapo-statement-at-cares-act-oversight-hearing.

2021.[57] Further, they wanted to leave already-pledged funds in place because they did not want to unduly constrain the next Treasury Secretary's actions. Section 4027 of the CARES Act allows funding to be used after the end of 2020 for loan modifications, restructuring, and other amendments; the exercise of options, warrants,[58] or other investments made in 2020 or administrative costs. If inadequate funding remained after funding was withdrawn, then these functions could not be carried out. Further, if the Treasury Secretary and Fed decided to revive these programs in the future, a reduction in CARES funding could potentially limit the future size and scope of the programs.

On November 19, 2020, Treasury Secretary Mnuchin wrote a letter to Fed Chairman Powell effectively terminating the Fed's CARES Act facilities at the end of 2020[59] and asking the Fed to return the unused funds to the Treasury.[60] In his opinion, by setting a December 31 termination date on the use of CARES Act funding, Congress signaled that it did not wish for these Fed facilities to continue providing assistance after that date. However, he called for the Fed's non–CARES Act programs to be extended, which they subsequently were until March 31, 2021.[61] All of the extended programs have had declining usage, and some have not extended any new assistance since the summer, whereas the CARES Act facilities all saw increased outstanding assistance up to their expiration. In this letter, the Treasury Secretary estimated $455 billion of the original $500 billion to have been unused, including $429 billion in unused funds for Federal Reserve facilities. On November 20, Chairman Powell agreed to work with Treasury to return the unneeded funds.[62]

The decision to extend the termination date on the facilities is governed by Section 13(3) of the Federal Reserve Act, not the CARES Act, and requires a finding by five Fed governors of "unusual and exigent circumstances" and Treasury Secretary approval—not congressional approval.[63] The CARES Act, by contrast, prevents the Treasury from providing further investments to backstop these facilities after the end of 2020. However, in practice the Fed would not need any further CARES investments to reopen the facilities and provide further assistance at a future date because the facilities had only $41 billion in assistance outstanding at the end of 2020. In January 2021, the Fed agreed to reduce the Treasury investments to $51.8 billion outstanding (of which $40.3 billion is invested in CARES Act programs and $11.5 billion is non–CARES Act programs).[64]

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[57] See, for example, House Financial Services Committee, "Waters Calls Out Mnuchin for Prematurely Ending Essential Emergency Lending Programs," press release, December 2, 2020, https://financialservices.house.gov/news/documentsingle.aspx?DocumentID=407043.

[58] The warrants taken were not exercised in 2020.

[59] By regulation, the expiration date of Fed facilities cannot be extended without approval by the Treasury Secretary. Later, the MSLP was extended until January 8 in order to allow loan applications received before December 14 to be processed.

[60] Treasury Secretary Mnuchin, letter to Federal Reserve Board Chairman Powell, November 19, 2020, https://home.treasury.gov/system/files/136/letter11192020.pdf.

[61] Federal Reserve, "Federal Reserve Board Announces Extension Through March 31, 2021, for Several of Its Lending Facilities That Were Generally Scheduled to Expire on or Around December 31," press release, November 30, 2020, at https://www.federalreserve.gov/newsevents/pressreleases/monetary20201130a.htm.

[62] Federal Reserve Chairman Powell, letter to Treasury Secretary Mnuchin, November 20, 2020, https://www.federalreserve.gov/foia/files/mnuchin-letter-20201120.pdf.

[63] Under law, the programs cannot be permanent, and under regulation, the Fed may extend the programs six months at a time with Treasury approval.

[64] Federal Reserve, Statistical Release H.4.1, January 7, 2021, at https://www.federalreserve.gov/releases/h41/current/h41.pdf. This announcement returned a portion of the pledged ESF amount that had been invested in Fed programs.

In December 2020, Congress agreed to another coronavirus relief package, which was signed into law as part of P.L. 116-260. P.L. 116-260 sustained the Secretary's decision to allow these programs to expire at the end of the year and withdrew the unused funding.[65]

Section 1003 of Division N of P.L. 116-260 immediately rescinded $429 billion of the $500 billion, which was provided by Title IV of the CARES Act to cover credit subsidies, and rescinded any remaining unobligated funds on January 9, 2021. The amount left after the rescission remains available to cover administrative expenses and fund the Special Inspector General for Pandemic Relief and the Congressional Oversight Commission. Treasury is still allowed to modify and restructure existing loans and investments and exercise warrants after January 9, 2021, but may be limited in doing so by the rescission.

Section 1005 prohibits the Federal Reserve from providing any further assistance through its programs backed by the CARES Act after the end of 2020. Secretary Mnuchin's decision to allow these programs to expire at the end of 2020 also prevented the Fed from providing future assistance, but since this decision was made at the Secretary's discretion, the new Treasury Secretary would have had the option to reverse it if Congress had not acted. The section also limits the Fed's ability to modify those programs in the future, including by reallocating CARES funding to new Fed programs. Finally, the section prohibits the Treasury Secretary from using the non–CARES Act assets of the ESF to backstop a re-established MSLP, MLF, and both corporate credit facilities. The Secretary may use those assets to backstop other Fed facilities, however, including the TALF.[66]

It was never made explicit why some Fed programs were backed by CARES Act funding and others were backed by the preexisting assets of the ESF when all of the programs were announced around the same time. But since Congress removed CARES Act funding from these programs, it follows that the Secretary cannot replace it with funds raised from the ESF's non–CARES Act assets.

Rescinding most of the Title IV funding was not necessary to prevent the Treasury Secretary from making new loans and investments in Fed programs in the future, because the Secretary's authority to do so expired at the end of 2020 under the CARES Act. Nevertheless, rescinding this funding could have at least two rationales.

First, reducing Treasury's investments in Fed programs below the amount that the Secretary had originally pledged to those programs ($195 billion) limits the potential growth of those programs if they were revived in the future for the reasons discussed above. (Section 1005 also prohibited the revival of those programs.)

Second, policymakers frequently argued that unused Title IV funding should be reallocated to other uses. It is true that the cost of the CARES Act was lower than expected, because most Title IV funds were unused. However, the cost to the government of enacting new spending or revenue measures equal to the unused Title IV funds is the same whether or not the Title IV funds are

However, only $114 billion of the $215 billion pledged was ever invested.

[65] 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.

[66] The act may have permitted TALF to be revived in the future because it was the only program backed by CARES Act funding that was initially created in the 2007-2009 financial crisis. The act states that it does not modify or limit the Fed's authority before enactment of the CARES Act.

rescinded. In its score of P.L. 116-260, CBO estimated that the reduction in Title IV funding would have no effect on outlays or the budget deficit.[67]

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 are routinely addressed through private short-term credit markets. 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 only solvent firms from failing because they are 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'."[68] 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.[69] In three episodes, the Fed has significantly 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.

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 COVID-19

[67] Congressional Budget Office (CBO), Estimate for Division N—Additional Coronavirus Response and Relief, H.R. 133, Consolidated Appropriations Act, 2021, P.L. 116-260, January 14, 2021, at https://www.cbo.gov/system/files/2021-01/PL_116-260_div_N.pdf. Similarly, see CBO, "Estimate for Senate Amendment 2652 to S. 178, the Delivering Immediate Relief to America's Families, Schools and Small Businesses Act," October 21, 2020, https://www.cbo.gov/system/files/2020-10/sa2652.pdf.pdf.

[68] 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.

[69] *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. Loans are *overcollateralized* when the value of the collateral exceeds the value of 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.

programs, assistance has been unsecured or 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, and continued providing assistance after private credit markets have returned to normal. 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; up to 90 days during pandemic
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 Mutual Fund Liquidity Facility	Money market funds, short-term debt issuers	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, ETFs, 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	Lenders, borrowers, and issuers of asset-backed securities	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.[70] But other businesses still find their operations disrupted and demand for their products constrained. As economic disruption persists, more firms will become insolvent absent federal assistance—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 might feed public perceptions that the Fed is bailing out failing firms.

[70] 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.

If it were too difficult to access Fed facilities, then risk to the Fed would be minimized. Use of the facilities, however, would be too limited to serve their purpose of ensuring borrowers frozen out of private markets receive liquidity or those suffering economic harm from COVID-19 are helped.[71]

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, as this could result in a less severe economic downturn.[72] 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.[73]

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.[74] 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.[75]

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[71] 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.

[72] 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.

[73] 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.

[74] U.S. Department of the 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/.

[75] It is debatable whether Treasury could have financed all of these programs at their announced size. (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? 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.[76] 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.[77] 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.[78] 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. Since markets are not perfectly competitive, the Fed's actions will benefit both financial intermediaries and borrowers to varying degrees.

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, as financial wealth is unevenly distributed. This analysis is incomplete, because it identifies the proximate

[76] In Chair Powell's view, the statutory requirement to operate broadly based facilities means that "we don't do facilities that are designed for individual industries." Creating a program dedicated to supporting one industry could lead to criticism that the Fed was "picking winners," which could be challenging for a politically independent agency. In the CARES Act, loans to specific industries was the only part of Title IV assistance that was directly administered by Treasury, not the Fed. Powell quoted in transcript from House Financial Services Committee, *Hearing on Monetary Policy*, June 17, 2020, at https://plus.cq.com/doc/congressionaltranscripts-5931098?0.

[77] 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/.

[78] 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).

rather than ultimate beneficiaries of the Fed's actions. Evaluating 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 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.[79]

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).[80] 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 the scope of economic damage was known. In hindsight, the economic disruption proved to be extreme, but many of the financial market losses were reversed after March.[81] 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,"[82] 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,[83] 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

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

[80] 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.

[81] Market conditions had normalized before some Fed programs became 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.

[82] Named for then-Federal Reserve Chair Alan Greenspan.

[83] 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.

true—then it would be profitable for firms and investors to take on risk at an above socially optimal level.[84] 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 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).[85] 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 but still 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, stable prices, and moderate long-term interest rates" (12 U.S.C. §225a). Economic disruptions caused by COVID-19 pushed unemployment extremely high by historical standards in spring 2020. Meanwhile, inflation has been below the Fed's 2% target since before the pandemic. In this context, the Fed's mandate called for a more stimulative monetary policy. Given the severity of the downturn, there was arguably a 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. When the Fed lowers the federal funds target, other interest rates tend to fall but on a less than one-to-one basis. 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.

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 net exports (exports less imports). (In this case, other countries have also responded to COVID-19 by

[84] 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.

[85] For more information, see, COVID-19 and Corporate Debt Market Stress, by Eva Su.

reducing interest rates, and the dollar exchange rate initially rose during the pandemic.) Through these channels, monetary policy can be used to stimulate overall spending in the short run.

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%.[86] 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.[87] 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 the Emergency Economic Stabilization Act of 2008 (P.L. 110-343), Congress granted the Fed the authority to begin paying interest on reserves that banks hold at the Fed.[88] 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%.

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 (in the short term) by historical standards.[89] 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

[86] 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.

[87] 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.

[88] 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.

[89] 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)
June 1981	19.1%	9.4%	10.4
May 1989	9.8%	4.5%	5.3
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 consumer 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."[90] Forward guidance has become more specific over the course of the pandemic. In its December statement, the Fed announced that it

> expects it will be appropriate to maintain [the zero lower bound] until labor market conditions have reached levels consistent with the Committee's assessments of maximum employment and inflation has risen to 2% and is on track to moderately exceed 2% for some time. In addition, the Federal Reserve will continue to increase its holdings of Treasury securities by at least $80 billion per month and of agency mortgage-backed securities by at least $40 billion per month until substantial further progress has been made toward the Committee's maximum employment and price stability goals.[91]

Experience with forward guidance during the 2007-2009 financial crisis points to some of its limitations. Forward guidance then offered specific dates and economic benchmarks for when policy would be changed in the future, but unexpected economic developments often derailed these more detailed plans. 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

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

[91] Federal Reserve, "Federal Reserve issues FOMC statement," press release, December 16, 2020, at https://www.federalreserve.gov/newsevents/pressreleases/monetary20201216a.htm.

conditions may, for some time, warrant keeping the target federal funds rate below levels the Committee views as normal in the longer run."[92]

Forward guidance is generally "just talk" that is not binding in the future or backed by market transactions. 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 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.[93] By March 17, the Fed's balance sheet had exceeded its post-financial crisis peak of $4.5 trillion (see **Figure 2**). On March 23, the Fed announced it would increase its purchases of Treasury securities and MBS to "the amounts needed to support smooth market functioning and effective transmission of monetary policy"[94] and, for the first time, purchase agency-backed commercial MBS.[95] Asset purchases in March were intended to both stimulate the economy and restore liquidity to Treasury and MBS markets.[96] Therefore, these

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

[93] 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, Federal Reserve: Recent Repo Market Intervention, by Marc Labonte.

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

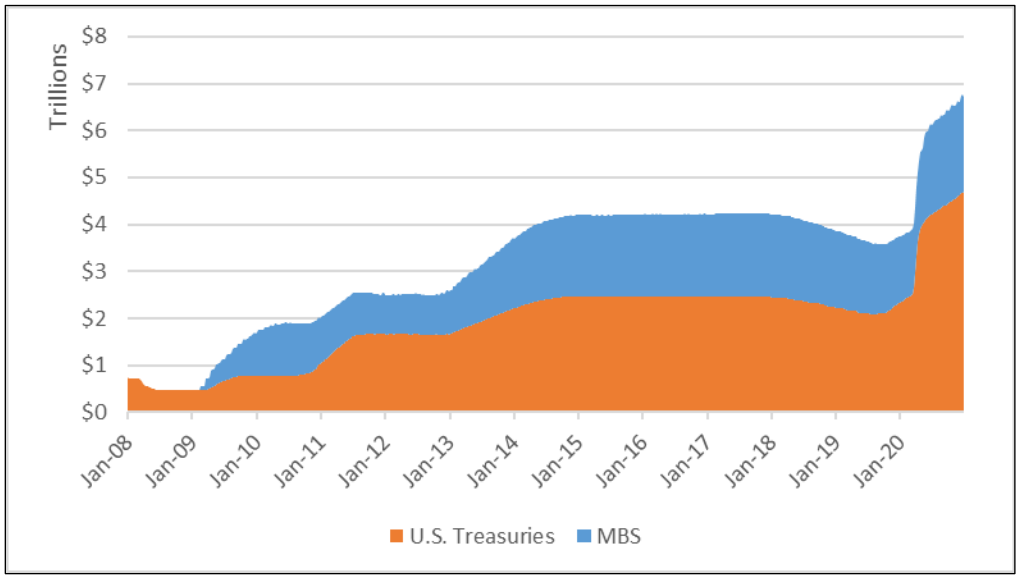
[95] See Woojung Park, Julia Gouny, and Haoyang Liu, "Federal Reserve Agency CMBS Purchases," *Liberty Street Economics*, Federal Reserve Bank of New York, July 16, 2020, at https://libertystreeteconomics.newyorkfed.org/2020/07/federal-reserve-agency-cmbs-purchases.html.

[96] See Michael Fleming, "Treasury Market Liquidity and the Federal Reserve During the COVID-19 Pandemic," *Liberty Street Economics*, Federal Reserve Bank of New York, May 29, 2020, at

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. 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. Purchases continued but have been gradually tapered down since then. Since June 2020, the Fed has pledged to increase its securities holdings by about $80 billion of Treasury Securities, $40 billion of MBS, and smaller amounts of CMBS each month and to continue to do so "until substantial further progress has been made toward the Committee's maximum employment and price stability goals."[97]

Figure 2. Federal Reserve Securities Holdings

1/1/2008-12/31/2020



Source: Federal Reserve.

Notes: MBS = mortgage-backed securities. MBS includes residential and commercial MBS. Total is at face value.

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.

https://libertystreeteconomics.newyorkfed.org/2020/05/treasury-market-liquidity-and-the-federal-reserve-during-the-covid-19-pandemic.html; Jiakai Chen et al., "MBS Market Dysfunctions in the Time of COVID-19," *Liberty Street Economics*, Federal Reserve Bank of New York, July 17, 2020, at https://libertystreeteconomics.newyorkfed.org/2020/07/mbs-market-dysfunctions-in-the-time-of-covid-19.html.

[97] Federal Reserve, "Federal Reserve Issues FOMC Statement," press release, December 16, 2020, at https://www.federalreserve.gov/newsevents/pressreleases/monetary20201216a.htm.

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 the pandemic lasts, high inflation is unlikely to pose a problem. However, the pace of money supply growth has 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. Budget deficits were historically high relative to GDP in FY2020. 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. It remains to be seen whether the confluence of large-scale Fed purchases of Treasury securities, large budget deficits, and the pandemic could create pressures that weaken the Fed's independence and the separation of monetary and fiscal policy. The strict separation of monetary and fiscal policy in place since the 1950s has not truly been tested, because the United States did not run extremely large budget deficits over that period except during the financial crisis and the pandemic. Some economists have speculated whether persistently large deficits, if they continued, could eventually leave the Fed with no option but to subordinate monetary policy to direct financing of the budget deficit.

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. These fears have been accentuated by the rapid rise in the stock market, housing prices, and certain other assets in 2020. 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 earlier 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 2007-2009 financial crisis because of the role that the housing bubble played in instigating the crisis. On the other hand, that 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 did not suffer disproportionately compared with the rest of the economy.

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. Although these actions received less scrutiny because they were not taken under the Fed's emergency authority, their influence on financial conditions should not be underrated.

At their peak usage, the Fed extended more credit through both its repos and central bank liquidity swaps (individually) than it did through its 13(3) programs collectively.

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. In December 2020, it promulgated a final rule in which it indicated that it intended to keep reserve requirements at zero permanently.[98] 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 over $3 *trillion* in May 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 were 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.[99]

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.[100] Unlike the discount window, its counterparties are not limited to banks, whom the Fed regulates (along with other federal regulators). 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.[101] The Fed started using repos again in September 2019 in response to repo market turmoil. Since then, the Fed has used repos to promote financial market liquidity instead of to target the federal funds rate. However, the Fed has also routinely borrowed cash in repo markets (called "reverse repos" from the lender's perspective) to withdraw liquidity from financial markets since the financial crisis began.

The Fed made repos available on a larger scale once the pandemic started in response to higher borrowing costs in repo markets.[102] From March 16, 2020 to May 1, 2020, the Fed made $1

[98] Federal Reserve, "Federal Reserve Board Invites Public Comment on Proposed Amendments to Regulation D and Issues Final Rule Amending Regulation D with Regard To Reserve Requirement Ratios on Transaction Accounts," press release, December 22, 2020, at https://www.federalreserve.gov/newsevents/pressreleases/monetary20201222a.htm. See also Federal Reserve, *Savings Deposits Frequently Asked Questions*, at https://www.federalreserve.gov/supervisionreg/savings-deposits-frequently-asked-questions.htm.

[99] 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.

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

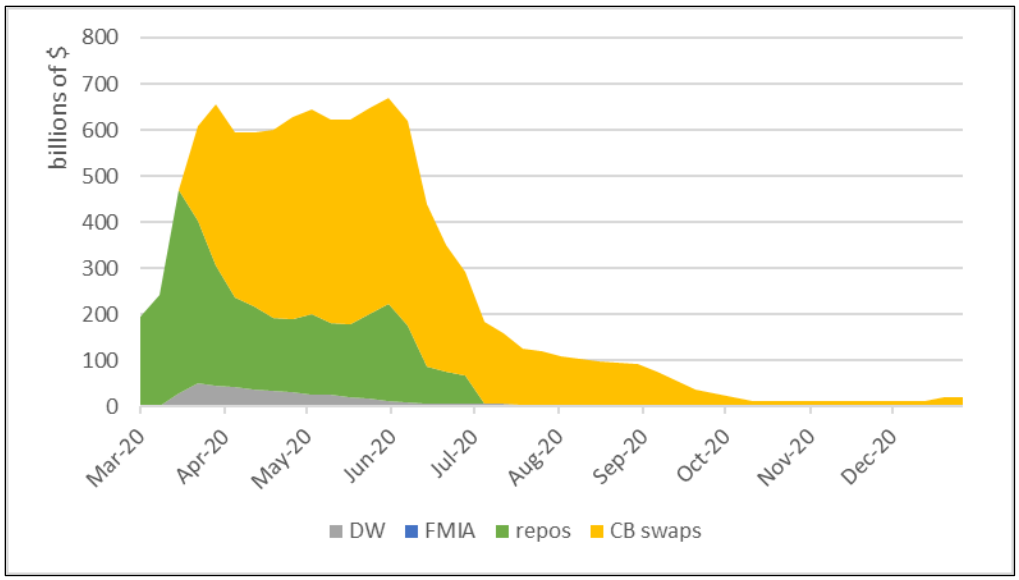
[101] For more on the Fed's recent monetary policy response, see CRS Insight IN11330, *Federal Reserve: Monetary Policy Actions in Response to COVID-19*, by Marc Labonte.

[102] Kevin Clark, Antoine Martin, and Tim Wessel, "The Federal Reserve's Large-Scale Repo Program," *Liberty Street*

trillion in overnight repos available at auction every day. Since May 1, 2020, the Fed has made $500 billion in overnight repos available daily. In addition, it has made an additional $500 billion in longer-term repos available at least once a week since March.[103] These repos are larger and longer-lasting than those offered since September 2019. Take-up rates have been significantly lower. As shown in **Figure 3**, repos outstanding peaked at $496 billion on March 17 and have been zero since July 8, 2020.[104] (Reverse repos to financial institutions have been below $1 billion since June 2020.)

Figure 3. Fed Assistance During the Pandemic Excluding 13(3) Facilities

3/1/20-12/31/20



Source: Federal Reserve, "Factors Affecting Reserve Balances—H.4.1," data release, various dates, https://www.federalreserve.gov/releases/h41/.

Notes: DW = discount window; FMIA = Foreign and International Monetary Authorities Repo Facility; repos = repurchase agreements; CB swaps = central bank liquidity swaps. See text for details.

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 offerings become permanent? By setting its lending rate above private rates, the Fed has ensured that private borrowers do not use the Fed's repos when private credit is available in the repo market. However, it is unclear how the private market would be affected if the Fed withdrew its large daily offerings, which act as a backstop for the private market.

Economics, Federal Reserve Bank of New York, August 03, 2020, at https://libertystreeteconomics.newyorkfed.org/2020/08/the-federal-reserves-large-scale-repo-program.html.

[103] 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.

[104] Federal Reserve, *Quarterly Report on Federal Reserve Balance Sheet Developments*, August 2020, at https://www.federalreserve.gov/publications/files/balance_sheet_developments_report_202008.pdf.pdf.

Foreign Central Bank Facilities

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 temporarily 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.[105] The Fed 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. Use of the facility peaked at $1.4 billion on May 13, 2020.

The temporary swap lines with nine additional central banks and the repo facility are scheduled to expire at the end of September 2021, although the Fed has extended the expiration date in the past.

Recent use of the swap lines quickly exceeded use during the 2012 euro crisis and have been at levels comparable to 2008. Swaps outstanding peaked at $449 billion on May 27, 2020. At that point, most of the swaps outstanding were with the European Central Bank and the Bank of Japan.[106] Use of the swap lines gradually tapered off and has been below $100 billion since mid-August and below $10 billion since mid-October 2020 (see **Figure 3**).

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."[107] 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

[105] Previously, the Fed had allowed foreign central banks to temporarily swap U.S. dollars for Treasury securities. 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 https://libertystreeteconomics.newyorkfed.org/2020/05/have-fed-swap-lines-reduced-dollar-funding-strains-during-the-covid-19-outbreak.html; Nicola Cetorelli, Linda S. Goldberg, and Fabiola Ravazzolo, "How Fed Swap Lines Supported the U.S. Corporate Credit Market amid COVID-19 Strains," *Liberty Street Economics*, Federal Reserve Bank of New York, June 12, 2020, at https://libertystreeteconomics.newyorkfed.org/2020/06/how-fed-swap-lines-supported-the-us-corporate-credit-market-amid-covid-19-strains.html.

[106] Federal Reserve, *Quarterly Report on Federal Reserve Balance Sheet Developments*, August 2020, at https://www.federalreserve.gov/publications/files/balance_sheet_developments_report_202008.pdf.pdf.

[107] For more information, see CRS In Focus IF11707, *The U.S. Dollar as the World's Dominant Reserve Currency*, coordinated by Rebecca M. Nelson.

credit risk involved (the foreign central bank bears the 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.

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 (except the two involving foreign central banks) 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 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 statutory changes 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.[108] 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 that are "sufficient 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."[109]

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.[110] In some cases, the final rule went 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 Stearns in 2008); 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.

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

[109] 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.

[110] 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.

Section 13(3) Provision	Final Rule Implementation
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."
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, 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."[111] 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." These restrictions were 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 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.[112]

Although seven of the facilities identified in the "Emergency Facilities" section are backed by the ESF, only five were backed by the CARES Act—TALF, MSLP, MLF, PMCCF, and SMCCF.[113] It is unclear why certain facilities backed by the ESF are subject to the CARES Act and others are not. The decision was not based on when the facility was announced or whether the facility had been previously used in the 2007-2009 financial crisis.

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[111] "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.

[112] 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.

[113] Facilities identified as backed by CARES Act funding in U.S. Treasury, *Exchange Stabilization Fund Statement Of Financial Position*, July 31, 2020, footnote 2, at https://home.treasury.gov/system/files/206/ESF_July_Trunc_Footnotes-82720.pdf.

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.[114]

Dodd-Frank Act

The Dodd-Frank Act contained a number of forward-looking disclosure provisions that apply to COVID-19-related actions.[115] Section 1101 required that details on any assistance provided under Section 13(3), including amounts and the identities of borrowers, be reported to the committees of jurisdiction within seven days, with updates every 30 days thereafter.[116] 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.[117]

Section 1102 of 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.

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 on the Fed, Treasury, and GAO.[118]

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.[119] Total loans or asset purchases through the facilities are published weekly as part

[114] 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.

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

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

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

[118] 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.

[119] 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.

of the Fed's balance sheet.[120] The Fed has also publicly reported on transactions under 13(3) facilities backed by the CARES Act and the PPPLF at least every 30 days.[121] Details of the report include "names and details of participants in each facility; amounts borrowed and interest rate charged; and overall costs, revenues, and fees for each facility."[122] The Fed also provides details on emergency facilities' activities in quarterly reports.[123]

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[120] See Federal Reserve, "Factors Affecting Reserve Balances—H.4.1," various dates, https://www.federalreserve.gov/releases/h41/.

[121] Transaction data available at https://www.federalreserve.gov/publications/reports-to-congress-in-response-to-covid-19.htm.

[122] 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.

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