The Fifth Report of the Congressional Oversight Commission

October 15, 2020

Commission Members
U.S. Representative French Hill
Bharat Ramamurti
U.S. Representative Donna E. Shalala
U.S. Senator Pat Toomey

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INTRODUCTION

This is the fifth report of the Congressional Oversight Commission ("Commission") created by the Coronavirus Aid, Relief, and Economic Security Act ("CARES Act").[1] The Commission's role is to conduct oversight of the implementation of Division A, Title IV, Subtitle A of the CARES Act ("Subtitle A") by the U.S. Department of the Treasury ("Treasury") and the Board of Governors of the Federal Reserve System ("Federal Reserve"). Subtitle A provides $500 billion to the Treasury for lending and other investments "to provide liquidity to eligible businesses, States, and municipalities related to losses incurred as a result of coronavirus."[2]

Of this amount, $46 billion is set aside for the Treasury itself to provide loans or loan guarantees to certain types of companies. Up to $25 billion is available for passenger air carriers, eligible businesses certified to inspect, repair, replace, or overhaul services, and ticket agents. Up to $4 billion is available for cargo air carriers, and up to $17 billion is available for businesses "critical to maintaining national security."[3] Any unused portions of this $46 billion, and the remaining $454 billion, may be used to support emergency lending facilities established by the Federal Reserve.

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

- The Federal Reserve's use of its authority under Subtitle A, including the use of contracting authority and administration of the provisions of Subtitle A.
- The impact of loans, loan guarantees, and investments made under Subtitle A on the financial well-being of the U.S. economy.
- The extent to which the information made available on transactions under Subtitle A has contributed to market transparency.
- The effectiveness of loans, loan guarantees, and investments made under Subtitle A in minimizing long-term costs to the taxpayers and maximizing the benefits for taxpayers.[4]

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

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

- What are the Treasury and the Federal Reserve doing with $500 billion of taxpayer money?
- Who is that money helping?[5]

At this time, the emergency lending facilities established by the Federal Reserve that are receiving CARES Act funds are:

Primary Market Corporate Credit Facility ("PMCCF") and Secondary Market Corporate Credit Facility ("SMCCF"): Through a special purpose vehicle ("SPV"), the PMCCF enables the Federal Reserve to purchase newly issued corporate bonds and portions of syndicated loans, and the SMCCF enables the Federal Reserve to purchase previously issued corporate bonds and exchange-traded funds ("ETFs") that invest in corporate bonds.[6] The Treasury has announced it intends to make a total equity investment of $75 billion in the SPV, which can collectively support up to $750 billion in purchases.[7] As of October 8, 2020, the Treasury had invested $37.5 billion.[8] As of October 8, 2020, the SMCCF had an outstanding amount of bond ETFs and individual corporate bond purchases of $13.12 billion and there had been no purchases by the PMCCF.[9]

Main Street Lending Program ("MSLP"): The MSLP is comprised of five facilities—three dedicated to for-profit businesses and two dedicated to nonprofit organizations. The Federal Reserve, through an SPV, acquires loans issued by lenders to small and medium-sized businesses and nonprofit organizations with up to 15,000 employees or 2019 revenues of $5 billion or less. The Treasury announced it intends to make an equity

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[5] Congressional Oversight Commission, *Questions About the CARES Act's $500 Billion Emergency Economic Stabilization Funds*, May 18, 2020, at 5, https://coc.senate.gov/sites/default/files/2020-08/20200518_Congressional_Oversight_Committee_1st_Report.pdf.
[6] Board of Governors of the Federal Reserve System, *Primary Market Corporate Credit Facility Term Sheet,* July 28, 2020, https://www.federalreserve.gov/newsevents/pressreleases/files/monetary20200728a9.pdf; Board of Governors of the Federal Reserve System, *Secondary Market Corporate Credit Facility Term Sheet*, July 28, 2020, https://www.federalreserve.gov/newsevents/pressreleases/files/monetary20200728a1.pdf.
[7] Board of Governors of the Federal Reserve System, *Secondary Market Corporate Credit Facility Term Sheet*, July 28, 2020, https://www.federalreserve.gov/newsevents/pressreleases/files/monetary20200728a1.pdf.
[8] Board of Governors of the Federal Reserve System, Statistical Release H.4.1, *Factors Affecting Reserve Balances of the Depository Institutions and Condition Statement of Federal Reserve Banks*, Oct. 8, 2020, at n.14, https://www.federalreserve.gov/releases/h41/. The SPV for the PMCCF and the SMCCF is Corporate Credit Facilities LLC.
[9] *Id.*

investment of $75 billion in this program, which can support up to $600 billion in lending.[10] All MSLP facilities are operational and are able to purchase eligible loans submitted by lenders registered to participate in the program. As of September 18, 2020, 586 lenders had registered to participate in the program, though only 188 of them had publicized that they were accepting loan applications from new customers.[11] Of the 188, only 146 lenders accept loan applications from both for-profit businesses and nonprofit organizations that are new customers.[12] As of October 8, 2020, the Treasury had invested $37.5 billion.[13] As of October 8, 2020, the Federal Reserve held $2.55 billion in loan participations purchased under the MSLP.[14]

Municipal Liquidity Facility ("MLF"): Announced on April 9, 2020, the MLF enables the Federal Reserve, through a SPV, to purchase short-term notes issued by state and local governments. The Treasury announced it intends to make an equity investment of $35 billion in the SPV, which can support up to $500 billion in lending.[15] As of October 8, 2020, the Treasury invested $17.5 billion.[16] To date, the MLF has purchased $1.65 billion in municipal notes.[17]

Term Asset-Backed Securities Loan Facility ("TALF"): The TALF enables the Federal Reserve, through an SPV, to make loans to U.S. companies secured by asset-backed securities backed by student loans, auto loans, credit card loans, loans guaranteed by the

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[10] Federal Reserve Bank of Boston, *Main Street Lending Program For-Profit Businesses Frequently Asked Questions*, July 31, 2020, https://www.bostonfed.org/mslp-faqs; Federal Reserve Bank of Boston, Aug. 6, 2020, https://www.bostonfed.org/-/media/Documents/special-lending-facilities/mslp/legal/frequently-asked-questions-faqs-nonprofit.pdf.

[11] The lender registration summary data was provided by the Federal Reserve on Sept. 21, 2020. Registered lenders that are accepting new applicants are listed on a state-by-state basis at: https://www.bostonfed.org/supervision-and-regulation/supervision/special-facilities/main-street-lending-program/information-for-borrowers.aspx.

[12] *Id.*

[13] Board of Governors of the Federal Reserve System, Statistical Release H.4.1, *Factors Affecting Reserve Balances of the Depository Institutions and Condition Statement of Federal Reserve Banks*, Oct. 8, 2020, at n.14, https://www.federalreserve.gov/releases/h41/. The SPV for the MSLP is MS Facilities LLC.

[14] *Id.*

[15] Board of Governors of the Federal Reserve System, *Municipal Liquidity Facility Term Sheet,* Aug. 11, 2020, https://www.federalreserve.gov/newsevents/pressreleases/files/monetary20200811a1.pdf; Federal Reserve Bank of New York, *FAQs: Municipal Liquidity Facility,* Aug. 11, 2020, https://www.newyorkfed.org/markets/municipal-liquidity-facility/municipal-liquidity-facility-faq.

[16] Board of Governors of the Federal Reserve System, Statistical Release H.4.1, *Factors Affecting Reserve Balances of the Depository Institutions and Condition Statement of Federal Reserve Banks*, Oct. 8, 2020, at n.14, https://www.federalreserve.gov/releases/h41/.

[17] *Id.* The SPV for the MLF is Municipal Liquidity Facility LLC.

Small Business Administration, and certain other assets.[18] The Treasury's $10 billion equity investment in this facility[19] can provide up to $100 billion in lending.[20] TALF had a total outstanding amount of $3.13 billion in loans as of October 8, 2020.[21]

In this report, we provide an in-depth analysis of the MLF. We also provide updates regarding recent key actions taken by the Treasury and the Federal Reserve regarding all of the lending programs and facilities under Subtitle A.

The Treasury's National Security Loan to YRC Worldwide Inc.

The Commission's third report raised concerns regarding the $700 million loan made by the Treasury to YRC Worldwide Inc. ("YRC") under Subtitle A's national security loan program.[22] In particular, the Commission questioned (1) whether YRC, a trucking service provider utilized domestically by the U.S. Department of Defense ("Department of Defense"), was appropriately designated by the Treasury and the Department of Defense as "critical to maintaining national security," and (2) whether YRC's precarious financial condition at the time of the loan exposed taxpayers to a significant risk of loss.[23]

On July 30, 2020, the Treasury sent the Commission a letter that provided additional information regarding the Treasury's loan to YRC.[24] After reviewing this letter, the Commission sent letters to Treasury Secretary Steven Mnuchin[25] and Defense Secretary Mark Esper on July

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[18] Board of Governors of the Federal Reserve, *Term Asset-Backed Securities Loan Facility Term Sheet,* July 28, 2020, https://www.federalreserve.gov/newsevents/pressreleases/files/monetary20200728a6.pdf.
[19] Board of Governors of the Federal Reserve System, Statistical Release H.4.1, *Factors Affecting Reserve Balances of the Depository Institutions and Condition Statement of Federal Reserve Banks*, Oct. 8, 2020, at n.14, https://www.federalreserve.gov/releases/h41/.
[20] Board of Governors of the Federal Reserve, *Term Asset-Backed Securities Loan Facility Term Sheet*, July 28, 2020, https://www.federalreserve.gov/newsevents/pressreleases/files/monetary20200728a6.pdf.
[21] Board of Governors of the Federal Reserve System, Statistical Release H.4.1, *Factors Affecting Reserve Balances of the Depository Institutions and Condition Statement of Federal Reserve Banks*, Oct. 8, 2020, https://www.federalreserve.gov/releases/h41/.
[22] Congressional Oversight Commission, *The Third Report of the Congressional Oversight Commission*, July 20, 2020, at 15-16, 31-34, https://coc.senate.gov/sites/default/files/2020-08/20200720_Congressional_Oversight_Commission_3rd_Report.pdf.
[23] *Id.*
[24] Letter from U.S. Department of the Treasury to Congressional Oversight Commission, dated July 30, 2020 (attached as Appendix A to The Fourth Report of the Congressional Oversight Commission, Aug. 21, 2020, https://coc.senate.gov/sites/default/files/2020-08/COC%204th%20Report_08.21.2020%20with%20Appendix%208-27%20update.pdf).
[25] Letter from Congressional Oversight Commission to Treasury Secretary Steven Mnuchin, dated Aug. 7, 2020 (attached as Appendix B to The Fourth Report of the Congressional Oversight Commission, Aug. 21, 2020,

30, 2020 requesting additional information regarding the loan to YRC. The Commission requested responses by August 27, 2020.[26]

On August 27, 2020, the Commission received a letter from the Treasury stating that it was actively working on responses to the Commission's questions and expected to provide them by September 4, 2020.[27] The Treasury sent the Commission its responses on September 4, 2020.[28] The Treasury and the Commission are in the process of coordinating the transmission of additional confidential materials responsive to the Commission's questions. Additionally, the Department of Defense sent Senator Toomey a letter dated September 2, 2020 stating that it expected to respond to the Commission's request for information by September 18, 2020.[29] The Department of Defense missed this deadline and—as of October 15, 2020—the Commission has yet to receive a response. Nor has the Commission received a response to its follow-up inquiry as to when the Department of Defense's response will be sent.

Hearing on the Municipal Liquidity Facility

The CARES Act empowers the Commission to hold hearings as part of its oversight work.[30] The Commission's fourth report noted the Commission's intention to hold a hearing to examine the MLF. That hearing was held on September 17, 2020. A video recording of the hearing and the prepared testimonies of the hearing witnesses are available on the Commission's website at https://coc.senate.gov. When the full hearing record is completed (including a final transcript and any supplemental statements for the record) it will also be available on the Commission's website. The following witnesses testified at the hearing on various topics concerning the MLF, including its efficacy, accessibility, and perceived shortcomings:

- Mr. Kent Hiteshew, Deputy Associate Director, Division of Financial Stability, Federal Reserve
- Mr. Chris Edwards, Director, Tax Policy Studies, Cato Institute

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https://coc.senate.gov/sites/default/files/2020-08/COC%204th%20Report_08.21.2020%20with%20Appendix%208-27%20update.pdf).

[26] Letter from Congressional Oversight Commission to Defense Secretary Mark Esper, dated Aug. 7, 2020 (attached as Appendix C to The Fourth Report of the Congressional Oversight Commission, Aug. 21, 2020, https://coc.senate.gov/sites/default/files/2020-08/COC%204th%20Report_08.21.2020%20with%20Appendix%208-27%20update.pdf).

[27] Appendix A of this report contains a copy of the Treasury's letter to the Commission dated Aug. 27, 2020.

[28] Appendix B of this report contains a copy of the Treasury's letter to the Commission dated Sept. 4, 2020.

[29] Appendix C of this report contains a copy of the Department of Defense's letter to Senator Toomey dated Sept. 2, 2020.

[30] CARES Act, Pub. L. No. 116-136, § 4020(e)(1), 134 Stat. 281 (2020).

- Mr. Marion Gee, President, Government Finance Officers Association & Finance Director, Metropolitan St. Louis Sewer District, Missouri
- Mr. Patrick McCoy, Director of Finance, Metropolitan Transit Authority
- Dr. Mark Zandi, Chief Economist, Moody's Analytics

The Commission asked the Treasury to send a representative to testify at the hearing, but the Treasury declined to do so. On September 29, 2020, the Commission sent the Treasury a letter requesting information regarding the Treasury's role and perspective with respect to the MLF. The Commission requested responses by October 16, 2020.[31]

[31] Appendix D of this report contains a copy of the Commission's letter to the Treasury dated Sept. 29, 2020.

EXECUTIVE SUMMARY

This fifth report of the Commission focuses on the implementation of the Municipal Liquidity Facility ("MLF") by the Federal Reserve and the Treasury.

In March, 2020, uncertainty caused by the COVID-19 pandemic significantly disrupted the municipal bond market. Rising interest rates, falling issuances, and net outflows from the municipal bond market threatened the ability of state and local governments to access credit.[32] To restore liquidity and stability in the municipal bond market, the Federal Reserve announced on April 9, 2020 that it would create the MLF to purchase notes from eligible state and local governments.[33] The Treasury has announced it intends to make an equity investment of $35 billion in this facility. As of October 8, 2020, the Treasury had invested $17.5 billion.[34] The MLF can purchase up to $500 billion in notes.[35]

Specifically, the MLF can purchase notes from U.S. states, the District of Columbia, U.S. counties with a population of at least 500,000 residents, U.S. cities with a population of at least 250,000, certain other cities and counties designated by certain governors, Revenue Bond Issuers designated by a governor, and certain multistate entities.[36] Territorial governments and Indian Tribes are currently ineligible to participate in the MLF. As of September 30, 2020, the MLF has purchased notes from two issuers:

- A $1.2 billion one-year note from the State of Illinois at an interest rate of 3.36%.[37]

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[32] Marco Cipriani, et al., *Municipal Debt Markets and the COVID-19 Pandemic*, Liberty Street Economics, June 29, 2020, https://libertystreeteconomics.newyorkfed.org/2020/06/municipal-debt-markets-and-the-covid-19-pandemic.html.

[33] Board of Governors of the Federal Reserve System, *Federal Reserve takes additional actions to provide up to $2.3 trillion in loans to support the economy*, Apr. 9, 2020, https://www.federalreserve.gov/newsevents/pressreleases/monetary20200409a.htm.

[34] Board of Governors of the Federal Reserve System, Statistical Release H.4.1, *Factors Affecting Reserve Balances of the Depository Institutions and Condition Statement of Federal Reserve Banks*, Oct. 8, 2020, at n.14, https://www.federalreserve.gov/releases/h41/.

[35] Board of Governors of the Federal Reserve, *Municipal Liquidity Facility Term Sheet*, Aug. 11, 2020, https://www.federalreserve.gov/newsevents/pressreleases/files/monetary20200811a1.pdf.

[36] *Id.*

[37] Board of Governors of the Federal Reserve System, *MLF Transaction-specific Disclosures*, Oct. 8, 2020, https://www.federalreserve.gov/publications/files/mlf-transaction-specific-disclosures-10-8-20.xlsx. Illinois reportedly was originally set to pay 3.82% on its 1-year note. *See* Shruti Singh & Amanda Albright, *Illinois Becomes First to Tap Fed Loans After Yields Surge*, Bloomberg, June 2, 2020, https://www.bloomberg.com/news/articles/2020-06-02/illinois-becomes-first-to-tap-fed-loans-after-bond-yields-

- A $450.7 million three-year note from the New York Metropolitan Transportation Authority at an interest rate of 1.93%.[38]

The MLF calmed the municipal markets and provided an emergency backstop. Rates for one to three year municipal notes are lower than COVID-19 pandemic peak levels, but spreads to Treasuries remain elevated relative to pre-pandemic conditions. Nearly all investment-grade issuers are able to access the capital markets.[39] However, the MLF is not fiscal stimulus and macroeconomic conditions remain strained relative to the start of the year.

The Commission held a hearing on September 17, 2020 to explore the MLF, its impact on the municipal bond market, the status of state and local budgets, and potential changes to the MLF. The hearing consisted of two panels of witnesses. The first panel consisted of Kent Hiteshew, the Deputy Associate Director for the Division of Financial Stability at the Federal Reserve. The second panel consisted of the following four witnesses:

- Chris Edwards, Director of Tax Policy Studies at the Cato Institute
- Mark Zandi, Chief Economist at Moody's Analytics ("Moody's")
- Pat McCoy, Director of Finance at New York's Metropolitan Transportation Authority ("MTA")
- Marion Gee, President of the Government Finance Officers Association ("GFOA") and Finance Director at the Metropolitan St. Louis Sewer District ("MSD")

The Commission asked the Treasury to send a representative to testify at the hearing, but the Treasury declined to do so. On September 29, 2020, the Commission sent the Treasury a letter requesting information regarding the Treasury's role and perspective with respect to the MLF. The Commission requested responses by October 16, 2020.[40]

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surge. The Federal Reserve applied its revised pricing retroactively. *See* Board of Governors of the Federal Reserve, *Municipal Liquidity Facility Term Sheet*, Aug. 11, 2020, https://www.federalreserve.gov/newsevents/pressreleases/files/monetary20200811a1.pdf (revised term sheet providing that "An Eligible Issuer that has issued Eligible Notes to the SPV may elect to reprice such Eligible Notes based on pricing revisions to Appendix B. The new pricing will be based on the applicable ratings at the time of the repricing.").

[38] Metropolitan Transportation Authority, *Notice Regarding Metropolitan Transportation Authority, $450,720,000, Transportation Revenue Bond Anticipation Notes, Series 2020B*, *CUSIP 59261AG92*, Aug. 26, 2020, retrieved Sept. 22, 2020 from Bloomberg terminal.

[39] Bloomberg L.P. (2017), *Bloomberg Barclays Municipal Index*, retrieved Sept. 22, 2020 from Bloomberg terminal.

[40] Appendix D of this report contains a copy of the Commission's letter to the Treasury dated Sept. 29, 2020.

The Commission heard testimony regarding at least seven potential changes to the MLF, including proposals pertaining to its (1) expiration; (2) purpose; (3) term length; (4) pricing; (5) use restrictions; (6) eligibility rules; and (7) lack of a facility for secondary market purchases of municipal bonds. The Commissioners' views differed on the wisdom of adopting any or all of the proposals, and this report includes a discussion of each Commissioner's respective views regarding the proposals.

Further, the Commission reports that it has continued its evaluation of the Federal Reserve's SMCCF and has concluded that the facility should stop making any purchases. Given the Federal Reserve's success in buoying corporate bond markets, and recognizing that primary market investment-grade corporate bond rates are now below pre-pandemic levels, the Commission does not believe that further secondary market corporate bond purchases through the SMCCF are necessary.

DISCUSSION OF THE MUNICIPAL LIQUIDITY FACILITY

I. BACKGROUND

A. MLF Term Sheet Comparison

The key terms of the MLF are summarized below and compared to the terms of other Federal Reserve emergency lending facilities.

Origination fees. Issuers that participate in the MLF must pay an origination fee equal to 0.1% of the principal amount of notes purchased by the MLF.[41] As a comparison, the TALF has an administration fee of 0.1% of the loan amount.[42] The MSLP's five facilities have an origination fee ranging from 0.75% to 1.0% and a loan servicing fee of 0.25%.[43] The PMCCF and SMCCF do not have origination fees.[44]

Pricing. The MLF prices notes based on a fixed spread over the overnight indexed swap rate for bonds with a comparable maturity, determined by the Federal Reserve, based on the issuer's ratings and bond's relevant tax status at the time of pricing.[45] On August 11, 2020, the Federal Reserve revised pricing for the MLF by reducing the interest rate spread on tax-exempt notes for each credit rating category by 50 basis points and reducing the amount by which the

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[41] Board of Governors of the Federal Reserve System, *Municipal Liquidity Facility Term Sheet,* Aug. 11, 2020, https://www.federalreserve.gov/newsevents/pressreleases/files/monetary20200811a1.pdf.
[42] Board of Governors of the Federal Reserve System, *Term Asset-Backed Securities Loan Facility,* July 28, 2020, https://www.federalreserve.gov/newsevents/pressreleases/files/monetary20200728a6.pdf.
[43] Board of Governors of the Federal Reserve System, *Main Street New Loan Facility Term Sheet,* July 28, 2020, https://www.federalreserve.gov/newsevents/pressreleases/files/monetary20200728a3.pdf; Board of Governors of the Federal Reserve System, *Main Street Priority Loan Facility Term Sheet,* July 28, 2020, https://www.federalreserve.gov/newsevents/pressreleases/files/monetary20200728a2.pdf; Board of Governors of the Federal Reserve System, *Main Street Expanded Loan Facility Term Sheet,* July 28, 2020, https://www.federalreserve.gov/newsevents/pressreleases/files/monetary20200728a5.pdf; Board of Governors of the Federal Reserve System, *Nonprofit Organization New Loan Facility,* July 28, 2020, https://www.federalreserve.gov/newsevents/pressreleases/files/monetary20200728a10.pdf; Board of Governors of the Federal Reserve System, *Nonprofit Organization Expanded Loan Facility,* July 28, 2020, https://www.federalreserve.gov/monetarypolicy/mainstreetlending.htm.
[44] Board of Governors of the Federal Reserve System, *Primary Market Corporate Credit Facility Term Sheet,* July 28, 2020, https://www.federalreserve.gov/newsevents/pressreleases/files/monetary20200728a9.pdf; Board of Governors of the Federal Reserve System, *Secondary Market Corporate Credit Facility Term Sheet,* June 28, 2020, https://www.federalreserve.gov/newsevents/pressreleases/files/monetary20200728a1.pdf.
[45] Board of Governors of the Federal Reserve System, *Municipal Liquidity Facility Term Sheet,* Aug. 11, 2020, https://www.federalreserve.gov/newsevents/pressreleases/files/monetary20200811a1.pdf.

interest rate for taxable notes is adjusted relative to tax-exempt notes.[46] A summary of the MLF's current pricing schedule is below.[47]

MLF Pricing by Credit Rating	
Rating*	**Spread (bps)**
AAA/Aaa	100
AA+/Aa1	120
AA/Aa2	125
AA-/Aa3	140
A+/A1	190
A/A2	200
A-/A3	215
BBB+/Baa1	275
BBB/Baa2	290
BBB/Baa3	330
Below Investment Grade	540
*To account for split ratings across different credit rating agencies, an average rating is generally used.	

In the event of any subsequent pricing revisions by the Federal Reserve, the term sheet provides that an eligible MLF issuer that has sold notes to the MLF may elect to reprice such notes. The new pricing will be based on the applicable ratings at the time of the repricing.[48]

As a comparison, pricing for the PMCCF is issuer-specific, informed by market conditions, plus a 1.0% facility fee.[49] The SMCCF purchases eligible individual corporate bonds and eligible bond ETFs in the secondary market at current fair market value. For bond ETF purchases, the term sheet provides that the SMCCF will avoid purchasing shares of eligible ETFs when they trade at prices that materially exceed the estimated portfolio net asset value.[50] The TALF charges different interest rates based on the type of collateral (i.e., collateralized loan

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[46] Board of Governors of the Federal Reserve System, *Federal Reserve Board announces revised pricing for its Municipal Liquidity Facility*, Aug. 11, 2020, https://www.federalreserve.gov/newsevents/pressreleases/monetary20200811a.htm.
[47] Board of Governors of the Federal Reserve System, *Municipal Liquidity Facility Term Sheet*, Aug. 11, 2020, https://www.federalreserve.gov/newsevents/pressreleases/files/monetary20200811a1.pdf.
[48] *Id.*
[49] Board of Governors of the Federal Reserve System, *Primary Market Corporate Credit Facility Term Sheet*, July 28, 2020, https://www.federalreserve.gov/newsevents/pressreleases/files/monetary20200728a9.pdf.
[50] Board of Governors of the Federal Reserve System, *Secondary Market Corporate Credit Facility Term Sheet*, June 28, 2020, https://www.federalreserve.gov/newsevents/pressreleases/files/monetary20200728a1.pdf.

obligations, U.S. Small Business Administration certificates, or other asset-backed securities ("ABS") that range from 0.75% to 1.5% over a pricing benchmark.[51] MSLP loans are priced at an adjustable rate of LIBOR plus 3.0%.[52]

Loan term length. The longest maturity note that the MLF and TALF will purchase is three years.[53] For comparison, the PMCCF can purchase notes with a maximum maturity of up to four years[54], while the SMCCF purchases bonds with a maximum maturity of up to five years.[55] MSLP loans have a maturity of five years.[56]

Principal payment structure. The MLF and PMCCF are both structured to allow issuers to repay the principal of their notes in a single payment (i.e., a "bullet payment") at the time of maturity.[57] The securities purchased by the SMCCF will mature or be sold by the SMCCF prior to maturity.[58] Loans made by the MLF, PMCCF, and TALF are pre-payable in whole or in part

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[51]Board of Governors of the Federal Reserve System, *Term Asset-Backed Securities Loan Facility*, July 28, 2020, https://www.federalreserve.gov/newsevents/pressreleases/files/monetary20200728a6.pdf.
[52] Board of Governors of the Federal Reserve System, *Main Street New Loan Facility Term Sheet*, July 28, 2020, https://www.federalreserve.gov/newsevents/pressreleases/files/monetary20200728a3.pdf; Board of Governors of the Federal Reserve System, *Main Street Priority Loan Facility Term Sheet*, July 28, 2020, https://www.federalreserve.gov/newsevents/pressreleases/files/monetary20200728a2.pdf; Board of Governors of the Federal Reserve System, *Main Street Expanded Loan Facility Term Sheet*, July 28, 2020, https://www.federalreserve.gov/newsevents/pressreleases/files/monetary20200728a5.pdf; Board of Governors of the Federal Reserve System, *Nonprofit Organization New Loan Facility*, July 28, 2020, https://www.federalreserve.gov/newsevents/pressreleases/files/monetary20200728a10.pdf; Board of Governors of the Federal Reserve System, *Nonprofit Organization Expanded Loan Facility*, July 28, 2020, https://www.federalreserve.gov/monetarypolicy/mainstreetlending.htm.
[53] Board of Governors of the Federal Reserve System, *Municipal Liquidity Facility Term Sheet*, Aug. 11, 2020, https://www.federalreserve.gov/newsevents/pressreleases/files/monetary20200811a1.pdf. Board of Governors of the Federal Reserve System, *Secondary Market Corporate Credit Facility Term Sheet*, June 28, 2020, https://www.federalreserve.gov/newsevents/pressreleases/files/monetary20200728a1.pdf.
[54] Board of Governors of the Federal Reserve System, *Primary Market Corporate Credit Facility Term Sheet,* July 28, 2020, https://www.federalreserve.gov/newsevents/pressreleases/files/monetary20200728a9.pdf.
[55] Board of Governors of the Federal Reserve System, *Secondary Market Corporate Credit Facility Term Sheet*, June 28, 2020, https://www.federalreserve.gov/newsevents/pressreleases/files/monetary20200728a1.pdf.
[56] Board of Governors of the Federal Reserve System, *Main Street New Loan Facility Term Sheet*, July 28, 2020, https://www.federalreserve.gov/newsevents/pressreleases/files/monetary20200728a3.pdf; Board of Governors of the
[57] Board of Governors of the Federal Reserve System, *Municipal Liquidity Facility Term Sheet*, Aug. 11, 2020, https://www.federalreserve.gov/newsevents/pressreleases/files/monetary20200811a1.pdf. Board of Governors of the Federal Reserve System, *Secondary Market Corporate Credit Facility Term Sheet*, June 28, 2020, https://www.federalreserve.gov/newsevents/pressreleases/files/monetary20200728a1.pdf.
[58] Board of Governors of the Federal Reserve System, *Secondary Market Corporate Credit Facility Term Sheet*, June 28, 2020, https://www.federalreserve.gov/newsevents/pressreleases/files/monetary20200728a1.pdf.

at the option of the borrower prior to maturity.[59] MSLP loans amortize following a two-year principle and one-year interest deferral period at a rate of 15% for years three and four, and 70% at the end of year five, and are pre-payable without penalty.[60]

Credit ratings. MLF-eligible issuers must have been rated investment grade (i.e., BBB-/Baa3 or better) as of April 8, 2020 by at least one nationally recognized statistical rating organization ("NRSRO") and rated at least BB-/Ba3 at the time of issuance to the MLF.[61] If the issuer is a multi-state entity or revenue-based issuer ("RBI"), the issuer must be rated at least A-/A3 as of April 8, 2020 by two NRSROs and rated at least BBB-/Baa3 at the time of issuance to the MLF.[62] PMCCF eligible issuers and individual bonds purchased by the SMCCF must have been rated investment grade (i.e., BBB-/Baa3 or better) as of March 22, 2020 by at least one NRSRO and rated at least BB-/Ba3 at the time of issuance.[63] The SMCCF's purchases of bond ETFs follow an investment objective to provide broad exposure to U.S. corporate bonds with most in investment grade and the remaining in high-yield (i.e., below BBB-/Baa3).[64] The TALF requires collateral to be in the highest long-term or the highest short-term investment-grade rating category from at least two NRSROs.[65]

Other eligibility requirements. The MLF supports lending to:

- Each U.S. state and the District of Columbia;

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[59] Board of Governors of the Federal Reserve System, *Term Asset-Backed Securities Loan Facility,* July 28, 2020, https://www.federalreserve.gov/newsevents/pressreleases/files/monetary20200728a6.pdf.
[60] Board of Governors of the Federal Reserve System, *Main Street New Loan Facility Term Sheet*, July 28, 2020, https://www.federalreserve.gov/newsevents/pressreleases/files/monetary20200728a3.pdf; Board of Governors of the Federal Reserve System, *Main Street Priority Loan Facility Term Sheet*, July 28, 2020, https://www.federalreserve.gov/newsevents/pressreleases/files/monetary20200728a2.pdf; Board of Governors of the Federal Reserve System, *Main Street Expanded Loan Facility Term Sheet*, July 28, 2020, https://www.federalreserve.gov/newsevents/pressreleases/files/monetary20200728a5.pdf; Board of Governors of the Federal Reserve System, *Nonprofit Organization New Loan Facility*, July 28, 2020, https://www.federalreserve.gov/newsevents/pressreleases/files/monetary20200728a10.pdf; Board of Governors of the Federal Reserve System, *Nonprofit Organization Expanded Loan Facility*, July 28, 2020, https://www.federalreserve.gov/monetarypolicy/mainstreetlending.htm.
[61] Board of Governors of the Federal Reserve System, *Municipal Liquidity Facility Term Sheet*, Aug. 11, 2020, https://www.federalreserve.gov/newsevents/pressreleases/files/monetary20200811a1.pdf.
[62] *Id.*
[63] Board of Governors of the Federal Reserve System, *Primary Market Corporate Credit Facility Term Sheet*, July 28, 2020, https://www.federalreserve.gov/newsevents/pressreleases/files/monetary20200728a9.pdf.
[64] Board of Governors of the Federal Reserve System, *Secondary Market Corporate Credit Facility Term Sheet*, June 28, 2020, https://www.federalreserve.gov/newsevents/pressreleases/files/monetary20200728a1.pdf
[65]Board of Governors of the Federal Reserve System, *Term Asset-Backed Securities Loan Facility*, July 28, 2020, https://www.federalreserve.gov/newsevents/pressreleases/files/monetary20200728a6.pdf.

- U.S. cities that (i) have a population exceeding 250,000 residents or (ii) are a designated city;
- U.S. counties that (i) have a population exceeding 500,000 residents or (ii) are a designated county;
- Multi-state entities;
- Designated cities and counties; and
- Designed revenue bond issuers.[66]

Designations work as follows: Only governors of states that have less than two cities and counties (on a combined basis) with 250,000 and 500,000 residents, respectively, may designate cities and counties located in their states for participation in the MLF, so that each state has at least two total cities and counties (on a combined basis) that may participate in the MLF. Also, only certain combinations of city and county designations are permitted: (1) the most populous city and most populous county; (2) the most populous city and second-most populous city; or (3) the most populous county and second-most populous county. In sum, each state has at least two total cities and counties that may participate in the MLF. Additionally, every governor may designate up to two revenue bond issuers, and the Mayor of the District of Columbia may designate one.[67]

Eligible states, cities, and counties could also be conduits for smaller jurisdictions within their borders if they are willing to obtain MLF notes themselves and then pass the proceeds onto the smaller jurisdiction.[68] The smaller jurisdiction cannot be insolvent.[69]

B. History of the MLF

At the Commission's September 17, 2020 hearing on the MLF, Kent Hiteshew, Deputy Associate Director of the Federal Reserve's Division of Financial Stability, testified about the impetus for the Federal Reserve's emergency actions in March and April 2020 to support the municipal bond market, including the announcement of the MLF. Specifically, he testified:

> As part of the broad financial markets dislocations that occurred amid rising concerns about the COVID pandemic in mid-March, the $3.9 trillion municipal bond market experienced historic levels of turmoil. The conditions that prevailed during March were

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[66] Board of Governors of the Federal Reserve System, *Municipal Liquidity Facility Term Sheet*, Aug. 11, 2020, https://www.federalreserve.gov/newsevents/pressreleases/files/monetary20200811a1.pdf.
[67] *Id.*
[68] Federal Reserve Bank of New York, *FAQs: Municipal Liquidity Facility*, Sept. 8, 2020, https://www.newyorkfed.org/markets/municipal-liquidity-facility/municipal-liquidity-facility-faq.
[69] Federal Reserve Bank of New York, *FAQs: Municipal Liquidity Facility*, Sept. 8, 2020, https://www.newyorkfed.org/markets/municipal-liquidity-facility/municipal-liquidity-facility-faq.

> unprecedented—far worse than during the onset of the financial crisis in late 2008 or even in the days after 9/11, when the municipal market was briefly closed. Interest rates soared more than 225 bps in just nine trading days, mutual fund investors pulled over $41 billion of assets out of the market in less than three weeks, and market functioning deteriorated to the point that buyers and sellers had difficulty determining prices. Ultimately, this meant that state and local governments were effectively unable to borrow, with most new issues canceled for lack of investor demand. Recognizing the severity of the current economic disruption, the Federal Reserve and Treasury responded with a variety of traditional and nontraditional policy responses across many capital markets. The Federal Reserve quickly moved to use its section 13(3) authority to directly support the municipal markets for the first time in the Federal Reserve's 100-plus-year history.[70]

In the face of this market turmoil, on March 23, 2020 the Federal Reserve announced it would be expanding the Commercial Paper Funding Facility ("CPFF"), the Primary Dealer Credit Facility ("PDCF"), and the Money Market Mutual Fund Liquidity Facility ("MMLF") to support the flow of credit in the economy.[71] As Mr. Hiteshew explained at the hearing, those facilities "had notable positive effects on the municipal markets. In particular, the inclusion of municipal variable-rate demand notes as eligible collateral in the MMLF on March 23 had an immediate and dramatic downward impact on short-term municipal rates."[72]

Then, on April 9, 2020, the Federal Reserve, with the approval of the Treasury, announced the MLF. As Mr. Hiteshew testified, the Federal Reserve's stated purpose for the MLF was to provide an emergency backstop for the municipal bond market.[73] He explained the Federal Reserve's view that:

> Consistent with the Federal Reserve's section 13(3) authority, our mandate is to serve as a backstop lender to accomplish these objectives—not as a first stop that replaces private

[70] Congressional Oversight Commission hearing on the Municipal Liquidity Facility, 116th Cong. (Sept. 17, 2020) (Prepared Testimony of Kent Hiteshew, Deputy Associate Director, Division of Financial Stability, Board of Governors of the Federal Reserve System), at 2-3, https://coc.senate.gov/sites/default/files/2020-09/MLF%20Testimony%20-%20HITESHEW_0.pdf.
[71] Board of Governors of the Federal Reserve System, *Federal Reserve announces extensive new measures to support the economy*, Mar. 23, 2020, https://www.federalreserve.gov/newsevents/pressreleases/monetary20200323b.htm. The CPFF, PDCF and MMLF are not within the jurisdiction of the Commission.
[72] Congressional Oversight Commission hearing on the Municipal Liquidity Facility, 116th Cong. (Sept. 17, 2020) (Prepared Testimony of Kent Hiteshew, Deputy Associate Director, Division of Financial Stability, Board of Governors of the Federal Reserve System), at 3, https://coc.senate.gov/sites/default/files/2020-09/MLF%20Testimony%20-%20HITESHEW_0.pdf.
[73] *Id.*

> capital. Accordingly, we have established MLF pricing based on a rate that is a premium to normal market conditions as measured over an extended period prior to the pandemic—not any single point in time. … Therefore, we measure the success of the MLF based not on its volume of lending, but rather on the condition of the municipal securities market and state and local government access to capital.[74]

While market conditions have improved, Mr. Hiteshew testified that "while we are not by any means projecting that we will see any kind of market turbulence like we saw in March, there are warning signs in the muni market that we should all be aware of" and that "[t]he coming cuts and potential downgrades of state and local governments could affect market conditions."[75]

The Commission agrees that the MLF succeeded in calming the municipal markets and in providing an emergency backstop. As Mr. Hiteshew testified, "[a]fter the historic sharp outflows from municipal bond funds in March, mutual funds have experienced 18 consecutive weeks of positive inflows, boosting demand for municipal securities and contributing to lower rates and record new issuance."[76] The Commission further agrees that the Federal Reserve's actions were not a form of direct fiscal aid to states and municipalities. By statute the Federal Reserve "cannot make grants or forgivable loans, and [it] cannot lend to insolvent" entities.[77]

C. MLF Transactions

Completed transactions. Since becoming operational on May 26, 2020, the MLF has purchased notes from two issuers totaling $1.65 billion. The MLF purchased from Illinois a $1.2 billion one-year general obligation note with an interest rate of 3.36%.[78] This rate is lower than the interest rate Illinois paid on comparable short-term notes during a public market sale in mid-

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[74] *Id.* at 4.

[75] Congressional Oversight Commission hearing on the Municipal Liquidity Facility, 116th Cong. (Sept. 17, 2020) (Testimony of Kent Hiteshew, Deputy Associate Director, Division of Financial Stability, Board of Governors of the Federal Reserve System), at 28.

[76] *Id.*

[77] *Id*.

[78] Illinois reportedly was originally set to pay 3.82% on its 1-year note. *See* Shruti Singh & Amanda Albright, *Illinois Becomes First to Tap Fed Loans After Yields Surge*, Bloomberg, June 2, 2020, https://www.bloomberg.com/news/articles/2020-06-02/illinois-becomes-first-to-tap-fed-loans-after-bond-yields-surge. Federal Reserve applied its revised pricing retroactively. *See* Board of Governors of the Federal Reserve, *Municipal Liquidity Facility Term Sheet*, Aug. 11, 2020, https://www.federalreserve.gov/newsevents/pressreleases/files/monetary20200811a1.pdf (revised term sheet providing that "An Eligible Issuer that has issued Eligible Notes to the SPV may elect to reprice such Eligible Notes based on pricing revisions to Appendix B. The new pricing will be based on the applicable ratings at the time of the repricing.").

May 2020.[79] It is, however, higher than the interest rate Illinois paid on a comparable short-term note prior to the pandemic (in November 2019), when it paid 1.78%.[80] The Illinois MLF note was rated Baa3 by Moody's Investor Service, BBB- by S&P, and BBB- by Fitch.[81] Illinois anticipates the $1.2 billion proceeds from the note will be used to meet shortfalls in the state's revenue for the fiscal year ending June 30, 2020.[82]

On August 26, 2020, the MLF purchased from the MTA a $450.7 million three-year revenue note at an interest rate of 1.93%.[83] The MTA anticipated that $450 million of the bond proceeds will be used to pay off the principal and interest due on certain MTA transportation revenue bond anticipation notes that matured on September 1, 2020.[84] The MTA's note is backed by transportation revenues earned by MTA and its affiliates.[85] The MTA sold the note to the MLF following a private market competitive bidding process on August 18, 2020 that resulted in 20 bids from 10 banks at an average interest rate of 2.79%.[86] By comparison, the last pre-pandemic note issued by the MTA of a similar term (in January 2020), had a true interest cost of 1.32%.[87]

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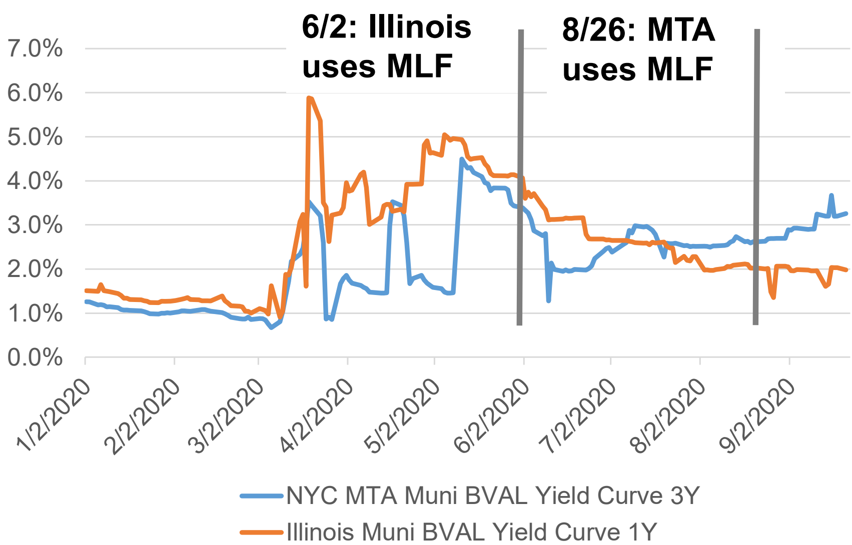
[79] *Id.*; State of Illinois, *General Obligation of Bonds, Series of May 2020,* May 2020, retrieved Sept. 9, 2020 from Bloomberg terminal. The SPV for the MLF is the Municipal Liquidity Facility LLC.
[80] Bloomberg L.P. (2017), *Pricing Information for CUSIP 4521524Z1 Issued Nov. 21, 2019*, retrieved Sept. 9, 2020 from Bloomberg terminal.
[81] Moody's Investors Service, *Illinois (State of) Ratings & Assessments,* as of Sept. 10, 2020, https://www.moodys.com/credit-ratings/Illinois-State-of-credit-rating-600024371 (*see General Obligation Certificates, Series of June 2020*); S&P Global Ratings, *State of Illinois General Obligation Bonds Series Of May 2020 Assigned 'BBB-' Rating,* Apr. 28, 2020, https://www.standardandpoors.com/en_US/web/guest/article/-/view/type/HTML/id/2420319; Fitch Ratings, *Fitch Assigns IL's $1.2 Billion GO Certificates a 'BBB-' Rating; Negative Outlook,* as of Tuesday, Apr. 28, 2020, https://www.fitchratings.com/entity/illinois-state-of-il-3292#insights.
[82] State of Illinois, *General Obligations Certificates, Series of June 2020, Purchase Agreement,* June 2, 2020, retrieved Sept. 9, 2020 from Bloomberg terminal (*see* Schedule I "Use of proceeds").
[83] Metropolitan Transportation Authority, *Notice Regarding Metropolitan Transportation Authority, $450,720,000, Transportation Revenue Bond Anticipation Notes, Series 2020B*, *CUSIP 59261AG92*, Aug. 26, 2020, retrieved Sept. 9, 2020 from Bloomberg terminal.
[84] Metropolitan Transportation Authority*, Offering Memorandum for MTA Transportation Revenue Bond Anticipation Notes, Series 2020B,* Aug. 18, 2020, retrieved Sept. 9, 2020 from Bloomberg terminal.
[85] *Id.*
[86] Muni Aution, *Bid Summary, Metropolitan Transporation Authority, New York, Transportation Revenue Bond Anticipation Notes, Series 2020B*, Aug. 18, 2020, https://www.muniauction.com/pma/results/MTA.TRBAN.20B.Closed/bid_summary.html; Metropolitan Transportation Authority*, Offering Memorandum for MTA Transportation Revenue Bond Anticipation Notes, Series 2020B*, Aug. 18, 2020, retrieved Sept. 9, 2020 from Bloomberg terminal.
[87] Congressional Oversight Commission hearing on the Municipal Liquidity Facility, 116th Cong. (Sept. 17, 2020) (Prepared Testimony of Pat McCoy, Finance Director, Metropolitan Transit Authority), at 4, https://coc.senate.gov/sites/default/files/2020-09/Witness%20Testimony%20McCoy%20Revised.pdf.

As seen in the chart below, both Illinois and the MTA were impacted by the financial distress in the municipal bond markets due to the COVID-19 pandemic with the yields on their outstanding bonds spiking significantly.[88]



Other interest. Several other entities have expressed interest in the MLF. Hawaii,[89] New Jersey,[90] New York's Suffolk County,[91] and the Port Authority of New York and New Jersey[92]

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[88] Bloomberg, *US NYC MTA Municipal BVAL Curve Three-Year Notes, US Illinois Municipal BVAL Curve One-Year Notes*, Jan. 1, 2020 through Sept. 21, 2020, retrieved Sept. 9, 2020 from Bloomberg terminal.

[89] Ray Finnertry, *Hawaii's Tourism Industry Has Ground To A Halt, Taking State Revenue Down With It*, NPR, Aug. 3, 2020, https://www.npr.org/2020/08/03/895378766/hawaiis-tourism-industry-has-ground-to-a-halt-taking-state-revenue-down-with-it; Kevin Dayton, *Gov. Ige warns* that *without more federal aid, public worker pay cuts or furloughs are inevitable,* Star Advertiser, July 5, 2020, https://www.staradvertiser.com/2020/07/05/hawaii-news/gov-ige-warns-that-without-more-federal-aid-public-worker-pay-cuts-or-furloughs-are-inevitable/.

[90] Office of Governor of the State of New Jersey, *Governor Murphy Signs COVID-19 Emergency Bond Act*, July 17, 2020, https://nj.gov/governor/news/news/562020/approved/20200716b.shtml; Greg Mennis & Ben Henken, *New Jersey Considers Tapping New Fed Borrowing Program to Meet Pension Contributions*, July 15, 2020, https://www.pewtrusts.org/en/research-and-analysis/articles/2020/07/15/new-jersey-considers-tapping-new-fed-borrowing-program-to-meet-pension-contributions.

[91] Amanda Albright, Bloomberg News, *Home of Hamptons Eyes Fed for Loan as Pandemic Slams Revenue*, Oct. 6, 2020, https://www.bloomberg.com/news/articles/2020-10-06/home-of-hamptons-eyes-fed-for-loan-as-pandemic-slams-revenue.

[92] The Port Authority of New York and New Jersey, *Port Authority Board Approves Use Of Federal Reserve Lending Program To Assist Agency During Covid-19 Recovery*, May 28, 2020, https://www.panynj.gov/port-authority/en/press-room/press-release-archives/2020-press-releases/port-authority-board-approves-use-of-federal-

reportedly considered accessing the program. Guam was also considering the program but is ineligible to participate because the MLF currently excludes U.S. territories.[93] Cook County, Illinois also considered using the facility, but ultimately chose not to participate at that time.[94] The State of Minnesota also elected not to participate, as it had sufficient liquidity from its operating funds.[95] New York City and Alameda County, California[96] chose not to use the MLF because they wanted longer repayment terms.[97] The State of Washington,[98] City of Chicago,[99] Nashville and Davidson County in Tennessee,[100] the Raleigh-Durham airport in North Carolina,[101] and Fresno County, California[102] have decided not to access the MLF because they can obtain lower rates in the private market.

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reserve-lending-pro.html; *see, e.g.*, Andrew Coen, *Port Authority eyes Fed lending program, but analysts doubt they'll use it*, Bond Buyer, June 4, 2020, https://www.bondbuyer.com/news/port-authority-eyes-fed-lending-program-but-analysts-doubt-theyll-use-it.

[93] Sarah Wynn, *Guam eyes Municipal Liquidity Facility*, Bond Buyer, Sept. 11, 2020, https://www.bondbuyer.com/news/guam-eyes-municipal-liquidity-facility.

[94] Yvette Shields, *Cook County warns of $400 million coronavirus sting in 2021 budget*, Bond Buyer, June 29, 2020, https://www.bondbuyer.com/news/cook-county-warns-of-400-million-coronavirus-sting-in-2021-budget.

[95] Yvette Shields, *Minnesota bond bill is collateral damage in coronavirus fight*, July 28, 2020, Bond Buyer, https://www.bondbuyer.com/news/minnesota-bond-bill-is-collateral-damage-in-coronavirus-fight.

[96] Alameda County Office of the Treasurer and Tax Collector, *Letter to the Congressional Oversight Commission*, Sept. 16, 2020, attached as Appendix E to this report.

[97] Paul Burton, *De Blasio says Fed liquidity program is a poor fit for New York*, Bond Buyer, Sept. 4, 2020, https://www.bondbuyer.com/news/de-blasio-says-fed-liquidity-program-is-a-poor-fit-for-new-york-city#:~:text=%22What%20we%20need%20is%20long,York%20Mayor%20Bill%20de%20Blasio.&text=%E2%80%9CThe%20Federal%20Reserve%20option%20is,said%20at%20Wednesday's%20media%20briefing.

[98] Washington State Treasurer, *State Treasurer Determines Municipal Liquidity Facility Not in Best Interest of Washington*, May 18, 2020, https://tre.wa.gov/mlf-not-in-best-interest/.

[99] Shruti Singh, *Chicago Projects $2 Billion Deficit Through 2021 on Pandemic*, Bloomberg, Aug. 31, 2020, https://www.bloomberg.com/news/articles/2020-08-31/chicago-projects-2-billion-deficit-through-2021-on-pandemic.

[100] Hilltop Securities, *Municipal Lending Facility Analysis for Metropolitan Government of Nashville and Davidson County*, May 12, 2020, https://www.nashville.gov/portals/0/SiteContent/council/docs/budget/fy21/council-questions/MetroNashvilleMLFAnalysis051220.pdf; Metropolitan Government of Nashville and Davidson County, Tennessee, *Council Member inquiries regarding the use of the Federal MLF Program for FY21*, May 26, 2020, at 2, https://www.nashville.gov/Portals/0/SiteContent/Council/docs/budget/fy21/council-questions/FederalPrograms.pdf.

[101] Connie Gentry, *Signs of life* at *RDU - and reason for optimism - as airport sticks to 'survival' budget*, Triangle Business Journal, June 12, 2020, https://www.bizjournals.com/triangle/news/2020/06/12/rdu-passenger-traffic-increases-optimism.html.

[102] National Association of Counties, *Letter on Municipal Liquidity Facility to the Congressional Oversight Commission*, Sept. 24, 2020, https://www.naco.org/sites/default/files/documents/NACo%20COC%20Letter%20on%20MLF.pdf.

At the Commission's September 17, 2020 hearing on the MLF, Mr. Hiteshew testified that that there is one additional potential MLF note currently in the pipeline.[103] On October 6, 2020, The Federal Reserve Bank of New York announced a deadline for eligible issuers to submit letters of intent to the MLF of no later than 30 days prior to the MLF's December 31, 2020 expiration.[104]

II. SUMMARY OF COMMISSION'S SEPTEMBER 17, 2020 MLF HEARING

At the Commission's September 17, 2020 hearing on the MLF, the Commissioners and witnesses acknowledged that the U.S. municipal bond market had recovered from the disruption it faced in the spring of 2020. The MLF was credited with calming the market and being responsible for state and local governments' current ability to access capital in the private markets.

Mr. Hiteshew of the Federal Reserve credited the MLF for "lower rates and record new issuance levels" in the municipal bond market.[105] Dr. Mark Zandi, Chief Economist at Moody's, recognized policymakers for "responding aggressively"[106] and "us[ing] the federal government's financial resources to help bridge American households and businesses to the other side of pandemic."[107] In particular, he observed that the MLF "eased investor concerns, allowing borrowing costs to remain low and the municipal bond market to function well."[108]

Two witnesses at the hearing who represent municipal issuers—Marion Gee of the Metropolitan St. Louis Sewer District and Patrick McCoy of the MTA—also acknowledged that the MLF had provided much needed relief to state and local governments by providing stability in the municipal bond market. Mr. Gee observed "that the creation of the MLF effectively

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[103] Congressional Oversight Commission hearing on the Municipal Liquidity Facility, 116th Cong. (Sept. 17, 2020) (Testimony of Kent Hiteshew, Deputy Associate Director, Division of Financial Stability, Board of Governors of the Federal Reserve System), at 27.
[104] Federal Reserve Bank of New York, *New York Fed Announces Notice of Interest Deadline for Municipal Liquidity Facility*, Oct. 6, 2020, https://www.newyorkfed.org/newsevents/news/markets/2020/20201006.
[105] Congressional Oversight Commission hearing on the Municipal Liquidity Facility, 116th Cong. (Sept. 17, 2020) (Prepared Testimony of Kent Hiteshew, Deputy Associate Director, Division of Financial Stability, Board of Governors of the Federal Reserve System), at 4, https://coc.senate.gov/sites/default/files/2020-09/MLF%20Testimony%20-%20HITESHEW_0.pdf.
[106] Congressional Oversight Commission hearing on the Municipal Liquidity Facility, 116th Cong. (Sept. 17, 2020) (Prepared Testimony of Mark Zandi, Chief Economist, Moody's Analytics), at 6, https://coc.senate.gov/sites/default/files/2020-09/MLF%20Testimony%20-%20HITESHEW_0.pdf.
[107] *Id.*
[108] *Id.*

calmed the municipal market at a critical time."[109] Mr. McCoy explained that the MLF was "critical in helping the MTA continue to operate,"[110] specifically by offering "a far preferable and less expensive choice" in terms of financing.[111]

However, Mr. Gee, Mr. McCoy, and Dr. Zandi each proposed reforms to the MLF that they believed would make it more accessible, while stressing that in their views direct fiscal aid would be the first best option for aiding state and local governments.[112] Their proposed reforms are discussed in the Analysis section of this report.

Chris Edwards, Senior Director of Tax Policy Studies at the Cato Institute, acknowledged that the MLF saved state and local issuers money, but took a more critical view of the facility. He raised concerns about the MLF's incompatibility with federalism and noted that the purchasing of municipal bonds could negatively impact the Federal Reserve's political independence.[113] Mr. Edwards also testified that then-Federal Reserve Chair Ben Bernanke had considered creating a facility similar to the MLF during the 2008 financial crisis, but ultimately decided against it as he views such intervention to be "'a political, fiscal issue,' not a central bank issue."[114]

The hearing also featured a robust discussion about the financial conditions of state and local governments. Dr. Zandi discussed his research that suggested state and local governments could face combined budgetary shortfalls through fiscal year 2022 totaling $450 billion to $650

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[109] Congressional Oversight Commission hearing on the Municipal Liquidity Facility, 116th Cong. (Sept. 17, 2020) (Prepared Testimony of Marion Gee, President, GFAO & Finance Director, Metropolitan St. Louis Sewer District, Missouri), at 5, https://coc.senate.gov/sites/default/files/2020-09/MLF%20Testimony%20-%20GEE.pdf.
[110] Congressional Oversight Commission hearing on the Municipal Liquidity Facility, 116th Cong. (Sept. 17, 2020) (Prepared Testimony of Patrick McCoy, Director of Finance, Metropolitan Transportation Authority), at 1, https://coc.senate.gov/sites/default/files/2020-09/Witness%20Testimony%20McCoy%20Revised.pdf.
[111] *Id.* at 4.
[112] *Id.*; Congressional Oversight Commission hearing on the Municipal Liquidity Facility, 116th Cong. (Sept. 17, 2020) (Prepared Testimony of Marion Gee, President, GFOA & Finance Director, Metropolitan St. Louis Sewer District), https://coc.senate.gov/sites/default/files/2020-09/MLF%20Testimony%20-%20GEE.pdf; Congressional Oversight Commission hearing on the Municipal Liquidity Facility, 116th Cong. (Sept. 17, 2020) (Prepared Testimony of Patrick McCoy, Director of Finance, Metropolitan Transportation Authority), at 3, https://coc.senate.gov/sites/default/files/2020-09/Witness%20Testimony%20McCoy%20Revised.pdf.
[113] Congressional Oversight Commission hearing on the Municipal Liquidity Facility, 116th Cong. (Sept. 17, 2020) (Prepared Testimony of Chris Edwards, Director of Tax Policy Studies, Cato Institute), at 3-4, https://coc.senate.gov/sites/default/files/2020-09/MLF%20Testimony%20-%20EDWARDS.pdf.
[114] *Id.* at 3.

billion—approximately 2.2% to 3.1%—of their annual GDPs.[115] Senator Toomey noted that the federal government had already provided $456 billion—approximately 2.2% of GDP—in direct aid to state and local governments to offset economic impacts caused by the coronavirus.[116] Mr. Edwards testified that state revenues likely will not fall as much as had been projected earlier in 2020. He noted that year-over-year tax receipts for state and local governments for 2020 were up in the first quarter and down only 3% in the second quarter.[117]

Representative Hill noted his view that closing state economies severely impacted state revenues, and correspondingly family livelihoods, while not materially reducing COVID infection rates per capita.[118]

However, testimony by Dr. Zandi, Mr. Gee, and Mr. McCoy presented a different outlook of the financial conditions of state and local governments. Dr. Zandi testified that the COVID-19 crisis "choked off tax revenues that state and local governments rely on to fund services and jobs" while, at the same time "caus[ing] demand to surge for state and local government services and support programs."[119] Mr. Gee echoed this issue and testified that "[d]ue to the uncertain timeframe of the COVID-19 public health emergency, expenses related to stopping the spread of the virus will continue to take its toll on state and local budgets [and] … adding lost revenues to the mix will only magnify the budgetary impacts of the health crisis."[120]

Dr. Zandi explained that unlike the federal government, states "cannot run budget deficits for very long" because of balanced budget laws.[121] Hence, in the absence of adequate federal

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115 Congressional Oversight Commission hearing on the Municipal Liquidity Facility, 116th Cong. (Sept. 17, 2020) (Testimony of Dr. Mark Zandi, Chief Economist, Moody's Analytics), at 67.
116 Congressional Oversight Commission hearing on the Municipal Liquidity Facility, 116th Cong. (Sept. 17, 2020) (Statement of Senator Pat Toomey), at 73.
117 Congressional Oversight Commission hearing on the Municipal Liquidity Facility, 116th Cong. (Sept. 17, 2020) (Testimony of Chris Edwards, Director of Tax Policy Studies, Cato Institute), at 58.
118 Congressional Oversight Commission hearing on the Municipal Liquidity Facility, 116th Cong. (Sept. 17, 2020) (Statement of Representative French Hill), at 9.
119 Congressional Oversight Commission hearing on the Municipal Liquidity Facility, 116th Cong. (Sept. 17, 2020) (Prepared Testimony of Mark Zandi, Chief Economist, Moody's Analytics), at 1, https://coc.senate.gov/sites/default/files/2020-09/MLF%20Testimony%20-%20ZANDI.pdf.
120 Congressional Oversight Commission hearing on the Municipal Liquidity Facility, 116th Cong. (Sept. 17, 2020) (Prepared Testimony of Marion Gee, President, GFOA & Finance Director, Metropolitan St. Louis Sewer District), at 5, https://coc.senate.gov/sites/default/files/2020-09/MLF%20Testimony%20-%20GEE.pdf.
121 Congressional Oversight Commission hearing on the Municipal Liquidity Facility, 116th Cong. (Sept. 17, 2020) (Prepared Testimony of Mark Zandi, Chief Economist, Moody's Analytics), at 3, https://coc.senate.gov/sites/default/files/2020-09/MLF%20Testimony%20-%20ZANDI.pdf.

support, state and local governments "have no choice but to quickly cut jobs and programs."[122] Consequently, in response to the COVID-19 crisis, state and local governments have already lost 1.1 million jobs which, Dr. Zandi testified, "include police officers and firefighters, healthcare workers, emergency responders, social service providers, and teachers—critical jobs at any time but particularly in a pandemic."[123]

Mr. Gee testified that state and local governments have already cut public services, such as "homeless prevention services, [and] public health related services"[124] and the National Association of Counties warns of additional "cuts to essential county services."[125] Dr. Zandi testified that "[t]he burden of these cuts will fall largely on lower- and middle-income Americans, many of whom rely on food, housing and educational assistance, medical care, unemployment insurance, and other social services. These are the same generally lower-income households that have suffered the brunt of the job and income losses during the pandemic."[126]

Mr. Hiteshew testified that he "agree[s] that the serious condition of state and local government balance sheets needs to be addressed … [and] we will need more fiscal policy to get through this situation."[127] He further acknowledged that "while state and local governments cannot cut their way out of this recession, neither can they borrow their way out of it. And if the legacy is operating deficit financing on state and local government balance sheets after this crisis is over, that will limit their ability to finance infrastructure, to educate our students, and to care for our elderly."[128]

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122 *Id*.
123 *Id*. at 5.
124 Congressional Oversight Commission hearing on the Municipal Liquidity Facility, 116th Cong. (Sept. 17, 2020) (Testimony of Marion Gee, President, GFOA & Finance Director, Metropolitan St. Louis Sewer District), at 19.
125 National Association of Counties, *Letter on Municipal Liquidity Facility to the Congressional Oversight Commission*, Sept. 24, 2020, https://www.naco.org/sites/default/files/documents/NACo%20COC%20Letter%20on%20MLF.pdf, attached as Appendix F to this report.
126 Congressional Oversight Commission hearing on the Municipal Liquidity Facility, 116th Cong. (Sept. 17, 2020) (Prepared Testimony of Mark Zandi, Chief Economist, Moody's Analytics), at 5, https://coc.senate.gov/sites/default/files/2020-09/MLF%20Testimony%20-%20ZANDI.pdf.
127 Congressional Oversight Commission hearing on the Municipal Liquidity Facility, 116th Cong. (Sept. 17, 2020) (Testimony of Kent Hiteshew, Deputy Associate Director, Division of Financial Stability, Board of Governors of the Federal Reserve System), at 23.
128 *Id.* at 33.

III. ANALYSIS OF THE MUNICIPAL LIQUIDITY FACILITY

The Commission heard testimony regarding at least seven aspects of the facility, including its (1) expiration; (2) purpose; (3) term length; (4) pricing; (5) use restrictions; (6) eligibility rules; and (7) the lack of a facility for secondary market purchases of municipal bonds. The Commissioners' views differed regarding potential changes to them.

The facility's expiration. At the hearing, Dr. Mark Zandi, Chief Economist of Moody's Analytics, Marion Gee, President of the Government Finance Officers Association and Finance Director of the Metropolitan St. Louis Sewer District, and Pat McCoy, Finance Director of the MTA all advocated extending the MLF's duration into 2021.[129] Mr. Gee noted that revenues lag economic conditions, so "the revenue challenges of state and local governments are in their nascency, … [and] [i]f the window were to remain open in 2021, it is very likely eligible entities would access the facility."[130]

Representative Shalala and Commissioner Ramamurti believe premature expiration of the MLF would pose unnecessary risks to market stability. Federal Reserve Chair Jerome Powell recently warned that the recovery "is still far from complete" and that "[t]oo little support would lead to a weak recovery."[131] He further stated that "[b]y contrast, the risks of overdoing it seem, for now, to be smaller. … The recovery will be stronger and move faster if monetary policy and fiscal policy continue to work side by side to provide support to the economy until it is clearly out of the woods."[132]

Representative Shalala and Commissioner Ramamurti note that in the wake of stalled direct aid negotiations, a broad, bipartisan coalition of representatives of tens of thousands of

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[129] Congressional Oversight Commission hearing on the Municipal Liquidity Facility, 116th Cong. (Sept. 17, 2020) (Testimony of Mr. Pat McCoy, Finance Director, Metropolitan Transit Authority), at 48-49; Congressional Oversight Commission hearing on the Municipal Liquidity Facility, 116th Cong. (Sept. 17, 2020) (Testimony of Dr. Mark Zandi, Chief Economist, Moody's Analytics), at 65; Congressional Oversight Commission hearing on the Municipal Liquidity Facility, 116th Cong. (Sept. 17, 2020) (Prepared Testimony of Marion Gee, President, GFOA & Finance Director, Metropolitan St. Louis Sewer District), https://coc.senate.gov/sites/default/files/2020-09/MLF%20Testimony%20-%20GEE.pdf.

[130] Congressional Oversight Commission hearing on the Municipal Liquidity Facility, 116th Cong. (Sept. 17, 2020) (Prepared Testimony of Marion Gee, President, GFOA & Finance Director, Metropolitan St. Louis Sewer District), https://coc.senate.gov/sites/default/files/2020-09/MLF%20Testimony%20-%20GEE.pdf.

[131] Board of Governors of the Federal Reserve System, *Recent Economic Developments and the Challenges Ahead*, Oct. 6, 2020, https://www.federalreserve.gov/newsevents/speech/powell20201006a.htm.

[132] *Id.*

state and local governments has called for the MLF's extension and expansion.[133] This coalition explained that "access to credit remains fragile and volatile" and that "[w]ithout timely and strong federal government efforts to support the municipal bond market and compensate for delayed revenues, our state and local governments will be forced to take actions that will exacerbate economic contraction."[134]

Commissioner Ramamurti and Representative Shalala are unpersuaded that market conditions have fully normalized. They note that municipal bond spreads to Treasuries remain elevated relative to pre-pandemic levels across the credit rating spectrum (see Chart 1 in Appendix H). In their view, spreads to Treasuries are a more accurate indicator of market condition than yields because spreads account for the macroeconomic context. Nevertheless, they note that these measures are all incomplete pictures because they are averages and because they capture only borrowers who are actually in the market at the time.

Representative Shalala and Commissioner Ramamurti further note that extending the MLF's expiration date could help accommodate jurisdictions that need to either change their laws or obtain voter approval to authorize MLF borrowing.[135] Commissioner Ramamurti believes the facility's duration should be extended immediately, particularly as municipal bond yields recently increased by 10 basis points when negotiations over an additional stimulus package stalled.[136]

Senator Toomey and Representative Hill believe that the MLF has achieved its purpose of restoring liquidity in the municipal bond market. They note that interest rates for state and local borrowers seeking three-year bridge loans are now below pre-pandemic rates for bonds rated A- or better (see Chart 2 in Appendix H)[137] (97% of eligible cities, states, and counties are

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[133] Letter from Government Finance Officers Association; International City/County Management Association; National Association of Counties, National Association of State Auditors, Comptrollers and Treasurers; National Association of State Treasurers; National League of Cities; and The United States Conference of Mayors to Chair Jerome Powell and Secretary Steven T. Mnuchin, dated Oct. 14, 2020, https://gfoaorg.cdn.prismic.io/gfoaorg/55818178-59da-41f8-ba44-383849bc85ed_MLFCoalitionLetter_FINAL.pdf.
[134] *Id*. at 3.
[135] *See, e.g*¸ Amanda Albright, *Fed's $500 Billion Muni-Lending Plan Faces Hurdles in State Laws*, Bloomberg Law, Apr. 21, 2020, https://news.bloomberglaw.com/securities-law/feds-500-billion-muni-lending-plan-faces-hurdles-in-state-laws.
[136] Amanda Albright & Shruti Singh, *America's Cities Fret as Stimulus Talks Collapse*, BloombergQuint, Oct. 7, 2020, https://www.bloombergquint.com/onweb/america-s-municipal-governments-fret-as-stimulus-talks-collapse.
[137] Bloomberg, *BVAL Muni AAA Yield Curve 3Y, USD US Corporate AA+, AA, AA- BVAL Yield Curve 3Y, US General Obligation BBB Muni BVAL Yield Curve 3Y*, 2009 through October 9, 2020, retrieved from Bloomberg terminal Oct. 9, 2020.

above this threshold).[138] They note that even BBB+ level municipalities are within historical averages. Federal Reserve Chair Jerome Powell also observed the recovery of capital markets, noting at a September 24, 2020 Senate Banking Committee Hearing that "Public markets are out there and they're working and the pricing is pretty good."[139]

Senator Toomey and Representative Hill also note that state and local governments have received over $450 billion—approximately 14% of all state and local government general revenue[140]—in direct COVID-19 related federal aid in 2020, and that the Federal Reserve is not aware of any state or local government that is unable to access credit at affordable rates.[141] Senator Toomey notes that the MLF falls under the jurisdiction of Section 13(3) of the Federal Reserve Act, which states that emergency facilities may only be created "[i]n unusual and exigent circumstances…" and that "any such program [be] terminated in a timely and orderly fashion."[142] Further he agrees with congressional colleagues who have stated that "emergency facilities are truly temporary" and failure to unwind them in an orderly fashion "will erode public confidence in the Board's ability to manage its balance sheet and leave the market susceptible to reading tea leaves of statements made by board officials."[143]

Representative Hill, noting the success of the MLF at the hearing, stated that "90 percent of states are double A [rated] or better … and have all accessed the market quite successfully."[144] In addition, Senator Toomey said "there has been no corporate subsidies" to the corporate bond primary market program, the PMCCF, as Mr. Hiteshew confirmed there have been no issuances

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[138] Popular Democracy Fed Up, *Aiming to Underachieve*, June 2020, https://populardemocracy.org/sites/default/files/Aiming%20to%20Underachieve%20-%20Fed%20Up%20White%20Paper%20June%202020.pdf.

[139] C-SPAN, *Treasury Secretary and Federal Reserve Chair Testimony on COVID-19 and the Economy*, Sept. 24, 2020, https://www.c-span.org/video/?475827-1/treasury-secretary-federal-reserve-chair-testimony-covid-19-economy&live, at 55:00 minutes.

[140] U.S. Census Bureau, *2018 State & Local Government Finance Historical Datasets and Tables*, Sept. 28, 2020, https://www.census.gov/data/datasets/2018/econ/local/public-use-datasets.html.

[141] Congressional Oversight Commission hearing on the Municipal Liquidity Facility, 116th Cong. (Sept. 17, 2020) (Testimony of Kent Hiteshew, Deputy Associate Director, Division of Financial Stability, Board of Governors of the Federal Reserve System), at 36 and 73.

[142] Federal Reserve Act Section 13(3), codified at 12 U.S.C. § 343(3)(B)(i)-(ii).

[143] Letter from Senator Elizabeth Warren, Senator David Vitter, et al, to Chair Janet Yellen, dated Aug. 18, 2014, https://www.federalreserve.gov/SECRS/2016/January/20160113/R-1476/R-1476_112315_130118_330099608751_1.pdf.

[144] Congressional Oversight Commission hearing on the Municipal Liquidity Facility, 116th Cong. (Sept. 17, 2020) (Statement of Representative Hill), at 83.

in that program.[145] Senator Toomey argues that "liquidity in the municipal bond market has been restored, and as such, the MLF should wind down."[146] Mr. Edwards of the Cato Institute, evaluating the MLF by the same standard, wrote in his testimony that "[e]conomic conditions and the municipal bond market are normalizing, indicating that the MLF should be discontinued."[147]

The facility's purpose. Mr. Gee, Mr. McCoy, and Dr. Zandi all disagreed with the interpretation that the Federal Reserve must limit the MLF to being a backstop lender of last resort for short-term liquidity only. Dr. Zandi testified that "[a]t minimum, the Fed should treat state and local governments as well as it does corporate borrowers that enjoy better interest rates and longer terms."[148] Mr. Gee and Mr. McCoy explained, "the Federal Reserve has taken a limited view of its role as only to calm the short-term liquidity market when it could have instead viewed the mission as providing effective credit subsidies, as it has with respect to corporate credit markets."[149]

Commissioner Ramamurti and Representative Shalala agree and note that the Federal Reserve has not strictly constrained itself to being only a lender of last resort in certain other Section 13(3) programs. They note the MSLP's stated purpose is "[e]nsur[ing] credit flows to small and mid-sized businesses,"[150] and the SMCCF purchases bonds from corporations at ordinary market prices—i.e., with no markup or penalty and no indication that "adequate credit accommodations" are otherwise unavailable.[151] In their view, the Federal Reserve cannot have

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[145] Congressional Oversight Commission hearing on the Municipal Liquidity Facility, 116th Cong. (Sept. 17, 2020) (Testimony of Kent Hiteshew, Deputy Associate Director, Division of Financial Stability, Board of Governors of the Federal Reserve System), at 34.
[146] *Id.*
[147] Congressional Oversight Commission hearing on the Municipal Liquidity Facility, 116th Cong. (Sept. 17, 2020) (Prepared Testimony of Chris Edwards, Director of Tax Policy Studies, Cato Institute), at 5, https://coc.senate.gov/sites/default/files/2020-09/MLF%20Testimony%20-%20EDWARDS.pdf.
[148] Congressional Oversight Commission hearing on the Municipal Liquidity Facility, 116th Cong. (Sept. 17, 2020) (Prepared Testimony of Mark Zandi, Chief Economist, Moody's Analytics), at 6, https://coc.senate.gov/sites/default/files/2020-09/MLF%20Testimony%20-%20ZANDI.pdf.
[149] Congressional Oversight Commission hearing on the Municipal Liquidity Facility, 116th Cong. (Sept. 17, 2020) (Prepared Testimony of Marion Gee, President, GFOA & Finance Director, Metropolitan St. Louis Sewer District), at 5, https://coc.senate.gov/sites/default/files/2020-09/MLF%20Testimony%20-%20GEE.pdf; *accord* Congressional Oversight Commission hearing on the Municipal Liquidity Facility, 116th Cong. (Sept. 17, 2020) (Prepared Testimony of Pat McCoy, Finance Director, Metropolitan Transit Authority), at 2, https://coc.senate.gov/sites/default/files/2020-09/Witness%20Testimony%20McCoy%20Revised.pdf.
[150] Press Release, *Federal Reserve Takes Additional Actions to Provide up to $2.3 Trillion in Loans to Support the Economy*, Federal Reserve (Apr. 9, 2020), https://www.federalreserve.gov/newsevents/pressreleases/monetary20200409a.htm.
[151] Federal Reserve Act § 13(3)(A), codified at 12 U.S.C. § 343(3)(A).

one mission for helping private entities while taking a different and narrower view for state and local governments.

Commissioner Ramamurti and Representative Shalala further note that "lender of last resort" appears nowhere in the CARES Act, Federal Reserve Act, or Dodd-Frank Wall Street Reform and Consumer Protection Act ("Dodd-Frank"), and that the statutes do not impose any restrictions unique to the MLF. In their view, affordable, flexible loans that provide cash (i.e., liquidity) are fully consistent with the CARES Act's purpose of "provid[ing] liquidity to eligible businesses, States, and municipalities."[152] While the MLF is not a substitute for direct aid, they believe the Federal Reserve's stringent interpretation of its mandate with respect to state and local governments makes the MLF "excessively punitive" toward municipal issuers.[153]

Senator Toomey and Representative Hill note the MLF was not designed to be a substitute for direct fiscal aid. In their view, congressional intent is clear that the MLF should only be used to provide liquidity, as CARES Act section 4003(c)(3)(E) reads, in its entirety— "(E) Government participants.—The Secretary shall endeavor to seek the implementation of a program or facility in accordance with subsection (b)(4) that provides liquidity to the financial system that supports lending to States and municipalities."[154]

Secretary Mnuchin, at a September 24, 2020 hearing before the Senate Banking Committee, reaffirmed that the CARES Act emergency facilities—such as the MLF—were only intended for the purpose of restoring liquidity. Specifically, he said, "[t]hese are emergency facilities. They are not intended to be subsidies and the best success is us not having to use them."[155] Mr. Hiteshew of the Federal Reserve reiterated that the MLF was never intended to compete with private market purchasers, testifying "[c]onsistent with the Federal Reserve's

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[152] CARES Act, Pub. L. No. 116-136, § 4003(a),(c)(3)(E), 134 Stat. 281 (2020); *accord* "Liquidity," Black's Law Dictionary (11th ed. 2019).
[153] Letter from Government Finance Officers Association; International City/County Management Association; National Association of Counties, National Association of State Auditors, Comptrollers and Treasurers; National Association of State Treasurers; National League of Cities; and The United States Conference of Mayors to Chair Jerome Powell and Secretary Steven T. Mnuchin, dated Oct. 14, 2020, https://gfoaorg.cdn.prismic.io/gfoaorg/55818178-59da-41f8-ba44-383849bc85ed_MLFCoalitionLetter_FINAL.pdf.
[154] CARES Act, Pub. L. No. 116-136, § 4003(c)(3)(E), 134 Stat. 281 (2020).
[155] C-SPAN, *Treasury Secretary and Federal Reserve Chair Testimony on COVID-19 and the Economy*, Sept. 24, 2020, https://www.c-span.org/video/?475827-1/treasury-secretary-federal-reserve-chair-testimony-covid-19-economy&live, at 54:30 minutes.

section 13(3) authority, our mandate is to serve as a backstop lender to accomplish these objectives—*not as a first stop that replaces private capital.*"[156]

Senator Toomey and Representative Hill underscore that all emergency lending facilities established under the CARES Act—including the MLF—are required to follow all applicable requirements under Section 13(3) of the Federal Reserve Act. In particular they note that Section 13(3)(A) of the Federal Reserve Act provides that "before discounting any such note, draft, or bill of exchange, the Federal Reserve bank shall obtain evidence that such participant in any program or facility with broad-based eligibility is unable to secure adequate credit accommodations from other banking institutions."[157] Senator Toomey and Representative Hill believe that characterizing this requirement as being tantamount to the Federal Reserve acting as a "lender of last resort" is appropriate and consistent with the law. They also note that, in 2014, there was a bipartisan letter stating that Dodd-Frank "direct[ed] the Board to establish a clear lender-of-last-resort policy…"[158] They also feel it is important to note that Dodd-Frank clearly requires all emergency lending facilities be "designed to ensure that any emergency lending program or facility is for the purpose of providing liquidity to the financial system, and not to aid a failing financial company, and that the security for emergency loans is sufficient to protect taxpayers from losses…"[159]

Furthermore, Senator Toomey cautions the Federal Reserve that any attempt to use the MLF as a grant-making mechanism is expressly illegal. He notes that CARES Act Section 4003(d)(3) reads in its entirety, "(3) Prohibition on loan forgiveness.—The principal amount of any obligation issued by an eligible business, State, or municipality under a program described in subsection (b) shall not be reduced through loan forgiveness."[160]

The facility's term length. The MLF allows only three-year notes, while the SMCCF, MSLF, and PMCCF allow four- or five-year terms. Mr. Hiteshew of the Federal Reserve

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[156] Congressional Oversight Commission hearing on the Municipal Liquidity Facility, 116th Cong. (Sept. 17, 2020) (Prepared Testimony of Kent Hiteshew, Deputy Associate Director, Division of Financial Stability, Board of Governors of the Federal Reserve System), at 4, https://coc.senate.gov/sites/default/files/2020-09/MLF%20Testimony%20-%20HITESHEW_0.pdf (emphasis added).
[157] Federal Reserve Act § 13(3), codified at 12 U.S.C. § 343(3)(B)(i)-(ii).
[158] Letter from Senator Elizabeth Warren, Senator David Vitter, et al, to Chair Janet Yellen, dated Aug. 18, 2014, https://www.federalreserve.gov/SECRS/2016/January/20160113/R-1476/R-1476_112315_130118_330099608751_1.pdf.
[159] Board of Governors of the Federal Reserve System, *Amendment to Regulation A- Extensions of Credit by Federal Reserve Banks*, Dec. 18, 2015, https://www.federalregister.gov/documents/2015/12/18/2015-30584/extensions-of-credit-by-federal-reserve-banks.
[160] CARES Act, Pub. L. No. 116-136, § 4003(d)(3), 134 Stat. 281 (2020).

testified "[t]here is no legal limitation" preventing the Federal Reserve from making the MLF term five years.[161]

Representative Shalala asked Mr. Hiteshew why maximum maturity for notes purchased by the MLF is three years. He responded that "[i]n terms of the maturity … the purpose of the program is to provide liquidity."[162] He noted that three years "reflects generally the maximum that state and local governments can borrow for liquidity purposes."[163] He noted that not only would purchasing longer-term debt shift the goal of the facility away from guaranteeing liquidity, but it would also be unnecessary, as there is "confidence at the long-end of the market."[164]

In contrast, Dr. Zandi, Mr. Gee, and Mr. McCoy all recommended lengthening the term. Mr. Gee and Mr. McCoy explained that state laws often preclude issuing debt shorter than 36 months.[165] Mr. Gee stated that with longer-term securities more "issuers could use the facility" and Mr. McCoy explained this would "free up liquid resources that could be used to address the crisis."[166] Dr. Zandi recommended a "term … closer to 10 years."[167]

Representative Shalala and Commissioner Ramamurti agree. They believe that a longer term is within the Federal Reserve's existing legal authority, reiterate their view that cash loans provide liquidity within the statutes' meaning, and further believe that state and local

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[161] Congressional Oversight Commission hearing on the Municipal Liquidity Facility, 116th Cong. (Sept. 17, 2020) (Testimony of Kent Hiteshew, Deputy Associate Director, Division of Financial Stability, Board of Governors of the Federal Reserve System), at 25.
[162] *Id.* at 16.
[163] *Id.* at 37.
[164] *Id.* at 37.
[165] Congressional Oversight Commission hearing on the Municipal Liquidity Facility, 116th Cong. (Sept. 17, 2020) (Prepared Testimony of Marion Gee, President, GFOA & Finance Director, Metropolitan St. Louis Sewer District), https://coc.senate.gov/sites/default/files/2020-09/MLF%20Testimony%20-%20GEE.pdf; Congressional Oversight Commission hearing on the Municipal Liquidity Facility, 116th Cong. (Sept. 17, 2020) (Testimony of Mr. Pat McCoy, Finance Director, Metropolitan Transit Authority), at 49-50.
[166] Congressional Oversight Commission hearing on the Municipal Liquidity Facility, 116th Cong. (Sept. 17, 2020) (Testimony of Mr. Pat McCoy, Finance Director, Metropolitan Transit Authority), at 50; Congressional Oversight Commission hearing on the Municipal Liquidity Facility, 116th Cong. (Sept. 17, 2020) (Prepared Testimony of Pat McCoy, Finance Director, Metropolitan Transit Authority), at 4, https://coc.senate.gov/sites/default/files/2020-09/Witness%20Testimony%20McCoy%20Revised.pdf.
[167] Congressional Oversight Commission hearing on the Municipal Liquidity Facility, 116th Cong. (Sept. 17, 2020) (Prepared Testimony of Mark Zandi, Chief Economist, Moody's Analytics), at 5, https://coc.senate.gov/sites/default/files/2020-09/MLF%20Testimony%20-%20ZANDI.pdf; Congressional Oversight Commission hearing on the Municipal Liquidity Facility, 116th Cong. (Sept. 17, 2020) (Testimony of Dr. Mark Zandi), at 65.

governments can and should have more flexibility to use the MLF for the kinds of longer-term capital borrowing that can stimulate the economy (while remaining free to prepay). They find unpersuasive the Federal Reserve's explanation of the three-year borrowing limit, which is inconsistent with the four- and five-year SMCCF, MSLP, and PMCCF terms. Furthermore, in Commissioner Ramamurti's view, the ten-year term recommended by Dr. Zandi is lawful and advisable. He notes that the Federal Reserve held Bear Stearns assets from 2008-2018.[168]

Senator Toomey and Representative Hill agree with Mr. Hiteshew that three years is adequate for the purpose of providing liquidity. They also believe that given normalizing market conditions relative to March 2020 (see Chart 3 in Appendix H)[169] and Mr. Hiteshew's statement that there is liquidity at the long end of the municipal bond market,[170] it does not make sense to extend the length of eligible loans at this time.

The facility's pricing. While neither the CARES Act nor the Federal Reserve Act mention the term penalty rate, in 2015 the Federal Reserve adopted by regulation a penalty-rate requirement, citing its agency practice as the basis for the requirement.[171] Under the regulation, the rate must be a "rate that is a premium to the market rate in normal circumstances, affords liquidity in unusual and exigent circumstances, and encourages repayment of the Eligible Notes and discourages use of the program as the unusual and exigent circumstances normalize."[172] The regulation provides that the penalty amount is based on open-ended, qualitative factors.[173]

Mr. Hiteshew testified that the MLF's pricing scheme was "based on the methodology that is grounded in Federal statute, regulation, and our longstanding principles, as adopted by Regulation A in 2015 by the Federal Reserve after a two-year rule making process that included broad public support across the ideological spectrum for the imposition of a premium rate in 13(3) loan facilities."[174]

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[168] Federal Reserve Bank of New York, *Maiden Lane Transactions*, Sept. 18, 2018, https://www.newyorkfed.org/markets/maidenlane.
[169] Bloomberg, *BVAL General Obligation Muni BVAL Yield Curve 5Y and 10Y*, January 1, 2020 through October 1, 2020, retrieved from Bloomberg terminal Oct. 2, 2020.
[170] Congressional Oversight Commission hearing on the Municipal Liquidity Facility, 116th Cong. (Sept. 17, 2020) (Testimony of Kent Hiteshew, Deputy Associate Director, Division of Financial Stability, Board of Governors of the Federal Reserve System), at 37.
[171] 12 C.F.R. § 201.4(d)(7); *Extensions of Credit by Federal Reserve Banks*, 80 Fed. Reg. 78959-01 (Dec. 18, 2015).
[172] *Id.*
[173] *Id.*
[174] Congressional Oversight Commission hearing on the Municipal Liquidity Facility, 116th Cong. (Sept. 17, 2020) (Testimony of Kent Hiteshew, Deputy Associate Director, Division of Financial Stability, Board of Governors of the Federal Reserve System), at 16.

Dr. Zandi, Mr. Gee, and Mr. McCoy all testified that the rates are overly punitive relative to both current and pre-pandemic market rates.[175] Mr. Gee testified that MLF pricing is not "competitive" with current market rates and that the current magnitude of the penalty means the MLF is "not … a viable option for municipal issuers, which is very likely the primary reason we see underutilization of the facility."[176] Mr. Gee added that "[t]he Federal Reserve should make the rate as low as possible[,] … as this saves taxpayer dollars, saves jobs, and prevents drastic budget cuts that may irreparably hurt local communities."[177]

Dr. Zandi recommended that the Federal Reserve "lower borrowing costs to make them less punitive,"[178] "including as low as the federal funds rate."[179] Mr. McCoy likewise "encourage[ed] the Federal Reserve to refine its pricing structures" so as not to "unduly penalize" borrowers, explaining that its MLF note is 61 basis points higher than the rate the MTA obtained on a similar note pre-pandemic.[180] He elaborated that each "one-basis-point change in the [MLF] rate is equivalent to $135,000 on [the MTA's] $450 million loan," so a 61-point point reduction would equal millions in savings that could be used to keep workers employed, or to offer more transit services or lower-cost services.[181] In contrast, Mr. Edwards

[175] Congressional Oversight Commission hearing on the Municipal Liquidity Facility, 116th Cong. (Sept. 17, 2020) (Prepared Testimony of Marion Gee, President, GFOA & Finance Director, Metropolitan St. Louis Sewer District), https://coc.senate.gov/sites/default/files/2020-09/MLF%20Testimony%20-%20GEE.pdf; Congressional Oversight Commission hearing on the Municipal Liquidity Facility, 116th Cong. (Sept. 17, 2020) (Prepared Testimony of Pat McCoy, Finance Director, Metropolitan Transit Authority), at 7, https://coc.senate.gov/sites/default/files/2020-09/Witness%20Testimony%20McCoy%20Revised.pdf; Congressional Oversight Commission hearing on the Municipal Liquidity Facility, 116th Cong. (Sept. 17, 2020) (Testimony of Dr. Mark Zandi, Chief Economist, Moody's Analytics), at 65.
[176] Congressional Oversight Commission hearing on the Municipal Liquidity Facility, 116th Cong. (Sept. 17, 2020) (Prepared Testimony of Marion Gee, President, GFOA & Finance Director, Metropolitan St. Louis Sewer District), https://coc.senate.gov/sites/default/files/2020-09/MLF%20Testimony%20-%20GEE.pdf.
[177] *Id*.
[178] Congressional Oversight Commission hearing on the Municipal Liquidity Facility, 116th Cong. (Sept. 17, 2020) (Testimony of Dr. Mark Zandi, Chief Economist, Moody's Analytics), at 65.
[179] Congressional Oversight Commission hearing on the Municipal Liquidity Facility, 116th Cong. (Sept. 17, 2020) (Prepared Testimony of Mark Zandi, Chief Economist, Moody's Analytics), at 6, https://coc.senate.gov/sites/default/files/2020-09/MLF%20Testimony%20-%20ZANDI.pdf.
[180] Congressional Oversight Commission hearing on the Municipal Liquidity Facility, 116th Cong. (Sept. 17, 2020) (Prepared Testimony of Pat McCoy, Finance Director, Metropolitan Transit Authority), at 4, https://coc.senate.gov/sites/default/files/2020-09/Witness%20Testimony%20McCoy%20Revised.pdf; Congressional Oversight Commission hearing on the Municipal Liquidity Facility, 116th Cong. (Sept. 17, 2020) (Testimony of Mr. Pat McCoy, Finance Director, Metropolitan Transit Authority), at 50.
[181] *Id.* at 78.

testified that saving borrowers interest costs provides only marginal benefits and is "not a goal worth undermining federalism for and pushing aside market interest rates."[182]

Representative Shalala and Commissioner Ramamurti agree with Dr. Zandi, Mr. Gee, and Mr. McCoy that the MLF's rates should be as low as possible. In their view, although the Federal Reserve lowered the rates by 50 basis points in August,[183] the Federal Reserve could lower them much further while still complying with Regulation A's penalty-rate provision—as illustrated by the substantial gap between MTA and Illinois's pre-pandemic and MLF and rates (158 and 61 bps, respectively). They stress that Regulation A provides for a penalty rate relative *to normal circumstances* (i.e., no pandemic).[184]

Commissioner Ramamurti and Representative Shalala believe that reducing the magnitude of the MLF penalty as much as possible would help ensure that the Federal Reserve is at least as generous with state and local governments as it is with borrowers participating in its other emergency lending programs.

As Commissioner Ramamurti explained, through the SMCCF, the Fed has purchased "a bond from Chevron at a rate of about 0.9% over more than 4-1/2 years, while a State like Wisconsin with the exact same credit rating as Chevron has to pay 1.28% over 3 years" to use the MLF.[185] Likewise, "the Fed has purchased a bond issued by Philip Morris that pays about 0.75% interest over a term of more than 4-1/2 years," while to use the MLF a "[s]tate government like Kentucky, which has the exact same credit rating as Philip Morris, [must] pay an interest rate of more than 2% over 3 years."[186] Commissioner Ramamurti and Representative Shalala do not believe the Federal Reserve should accept a lower rate of return from certain borrowers while imposing a higher one on state and local governments of the same (or better) credit quality—a fairness principle that applies irrespective of whether purchases are on primary or secondary markets.

Further, Representative Shalala and Commissioner Ramamurti believe the Federal Reserve's disparate treatment of private and municipal borrowers may have an outsized impact

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[182] Congressional Oversight Commission hearing on the Municipal Liquidity Facility, 116th Cong. (Sep. 17, 2020) (Prepared Testimony of Chris Edwards, Director of Tax Policy Studies, Cato Institute), https://coc.senate.gov/sites/default/files/2020-09/MLF%20Testimony%20-%20EDWARDS.pdf.

[183] Board of Governors of the Federal Reserve System, *Federal Reserve Board announces revised pricing for its Municipal Liquidity Facility*, Aug. 11, 2020, https://www.federalreserve.gov/newsevents/pressreleases/monetary20200811a.htm.

[184] 12 C.F.R. § 201.4(d)(7).

[185] Congressional Oversight Commission hearing on the Municipal Liquidity Facility, 116th Cong. (Sept. 17, 2020) (Statement of Commissioner Bharat Ramamurti), at 24.

[186] *Id.* at 22.

on the minority communities most impacted by the pandemic. As Commissioner Ramamurti explained, "a worker laid off in the public sector is 20 percent more likely to be black than a worker who loses his or her job in the private section,"[187] which "is part of the reason why the black unemployment rate currently is 5.7 percentage points higher than the white unemployment rate."[188] Moreover, he stated, "black families do not share equally in th[e] [Federal Reserve'] success" in "boost[ing] the stock market," because black families "make up more than 13 percent of the U.S. population but own only 1.5 percent of stocks."[189]

Finally, Commissioner Ramamurti and Representative Shalala note that the MTA has never defaulted on a bond.[190] Commissioner Ramamurti further notes that Senator Toomey did not raise the below concerns about the MTA at the Commission's hearing.

Senator Toomey and Representative Hill note that much of the Federal Reserve's Regulation A stemmed from Dodd-Frank. They believe that charging a "penalty rate"—i.e., a rate in excess of that charged by the private market—is consistent with requirements stated in the Federal Reserve Act and requirements mirrored in Dodd-Frank. They recall that when the Federal Reserve was crafting Regulation A to comply with Section 1101 of Dodd-Frank, Senator Elizabeth Warren, Senator David Vitter, and other Members of Congress advocated to include a penalty-rate provision in the final rule. Specifically, they wrote to then Federal Reserve Chair Janet Yellen that "[t]o reduce the moral hazard associated with the emergency lending program, the Board should make clear that any lending it provides through the program will be at a 'penalty rate.'"[191]

Further, Senator Toomey and Representative Hill believe that the MLF has successfully met the criteria the Federal Reserve laid out for the facility. They note that the MLF would

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[187] *Id.* at 39-40 (referencing Dean Baker & Hayley Brown, *Cutting State and Local Budgets is an Attack on the Country's Black Workers*, Center for Economic and Policy Research, June 16, 2020, https://cepr.net/cutting-state-and-local-budgets-is-an-attack-on-the-countrys-black-workers/).

[188] *Id.* at 39-40 (referencing U.S. Bureau of Labor Statistics, *The Employment Situation—August 2020*, Sept. 4, 2020, https://www.bls.gov/news.release/empsit.nr0.htm).

[189] *Id.* at 39 (referencing Lenore Palladino, *The Contribution of Shareholder Primacy to the Racial Wealth Gap, Roosevelt Institute*, Feb. 2020, https://rooseveltinstitute.org/wp-content/uploads/2020/07/RI_TheContributionofShareholderPrimacy_Working-Paper_202001.pdf; U.S. Census Bureau, *Quick Facts*, https://www.census.gov/quickfacts/fact/table/US/PST045219 (last visited Sept. 22, 2020). Editor's note: Commissioner Ramamurti is Managing Director of the Corporate Power program at the Roosevelt Institute.

[190] Email correspondence from Pat McCoy, Finance Director of the Metropolitan Transit Authority, to Congressional Oversight Commission staff, dated Oct. 12, 2020.

[191] Letter from Senator Elizabeth Warren, Senator David Vitter, et al, to Chair Janet Yellen, dated Aug. 18, 2014, https://www.federalreserve.gov/SECRS/2016/January/20160113/R-1476/R-1476_112315_130118_330099608751_1.pdf.

provide significant savings to issuers in an environment similar to March of 2020—when the nation was at the peak of disruption caused by COVID-19—but not in pre-pandemic environments, nor environments like the current one where they view that the municipal market interest rates have recovered (see Chart 4 in Appendix H). Further, they note that that interest rate yields for investment-grade municipal debt are now below pre-pandemic levels.

Senator Toomey and Representative Hill also note that in their view the vast majority of state and local issuers have access to private credit at negative real interest rates, meaning municipalities are effectively being paid to borrow money. They note that according to the Federal Bureau of Labor Statistics, annual inflation was 1.4% as of September 2020.[192] They apply this rate to the range of municipal borrowing costs of 0.16% for AAA rated entities and 1.25% for BBB- rated entities, resulting in real interest rates ranging between -1.24% and -0.15%.[193]

In their view, these low rates benefit all Americans. They note that in particular, African Americans and Hispanic Americans' median net worth increased 33 and 65% respectively from 2016 to 2019.[194] Senator Toomey and Representative Hill note that in their view, since private market rates are already so low as to be effectively negative, there is no room for the Federal Reserve to undercut the private market absent a grant program, which is not permitted under the CARES Act or the Federal Reserve Act. They are concerned such a program would create a dangerous precedent for future business cycles.

Consistent with Mr. Hiteshew's testimony, Senator Toomey and Representative Hill believe it is important to note that the very existence of the MLF lowered rates for municipal securities, including new issues, and allowed the market to better function.[195] At the Commission's September 17, 2020 hearing on the MLF, Mr. Gee acknowledged that the MSD has benefited from the increased market function when Senator Toomey noted that the MSD

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192 Bureau of Labor Statistics, *Consumer Price Index – September 2020,* Oct. 13, 2020, https://www.bls.gov/news.release/pdf/CPI.pdf.

193 Bloomberg, *BVAL General Obligation Muni BVAL Yield Curve 3Y BBB-, BBB, BBB+, A-, A, A+, AA-, AA, AA+, AAA*, January 1, 2020 through October 8, 2020, retrieved from Bloomberg terminal Oct. 9, 2020. Figures less BLS 1.4% September year-over-year inflation figure.

194 Board of Governors of the Federal Reserve System, *Disparities in Wealth by Race and Ethnicity in the 2019 Survey of Consumer Finances*, Sept. 28, 2020, https://www.federalreserve.gov/econres/notes/feds-notes/disparities-in-wealth-by-race-and-ethnicity-in-the-2019-survey-of-consumer-finances-20200928.htm.

195 Congressional Oversight Commission hearing on the Municipal Liquidity Facility, 116th Cong. (Sept. 17, 2020) (Prepared Testimony of Kent Hiteshew, Deputy Associate Director, Division of Financial Stability, Board of Governors of the Federal Reserve System), at 4, https://coc.senate.gov/sites/default/files/2020-09/MLF%20Testimony%20-%20HITESHEW_0.pdf.

could currently issue three-year notes for as little as 21 basis points.[196] Similarly, at the hearing Mr. McCoy of the MTA noted that by issuing a note to the MLF rather than the market the MTA saved 87 basis points—or $8.235 million over the life of the note.[197] Representative Hill noted that the MTA's ability to receive a better rate from the Federal Reserve than the private market may not reflect the Federal Reserve's mission of being a backstop lender.[198]

Senator Toomey notes that the Federal Reserve has a statutory mandate to run these emergency facilities in a manner that protects taxpayer dollars.[199] Further, given the MTA's well-documented history of financial troubles and mismanagement, he is concerned that the rates charged to the MTA may not have been high enough to ensure taxpayers do not see a loss on the loan. He notes that in November 2018—well before the COVID-19 pandemic—the New York Times wrote "[t]he [MTA] appears to be in its worst financial shape in a decade."[200] The same article went on to say "[t]he latest deficits were caused in part by declining ridership, which has led to lower revenue projections…[o]fficials blamed the drop on competition from Uber and other ride-hail apps."[201] Senator Toomey observes that MTA's long-term debt tripled between 2000 and 2019 to $35.4 billion.[202] He further notes that an August 15, 2019 report by Morrison Foerster projected that "[w]ithout changes to the status quo, the MTA has projected total deficits of about $500 million in 2020, soaring to $1 billion in 2022."[203] In Senator Toomey's view, a major driver of this deficit is the MTA's refusal to address rampant abuse of its overtime system. He notes that in 2010, the New York State Comptroller's Report found:

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[196] Congressional Oversight Commission hearing on the Municipal Liquidity Facility, 116th Cong. (Sept. 17, 2020) (Statement of Senator Pat Toomey), at 88; Congressional Oversight Commission hearing on the Municipal Liquidity Facility, 116th Cong. (Sept. 17, 2020) (Testimony of Marion Gee, President, Government Finance Officers Association; Finance Director, Metropolitan St. Louis Sewer District, Missouri), at 89.
[197] Congressional Oversight Commission hearing on the Municipal Liquidity Facility, 116th Cong. (Sept. 17, 2020) (Testimony of Patrick McCoy, Director of Finance, Metropolitan Transportation Authority), at 78.
[198] Congressional Oversight Commission hearing on the Municipal Liquidity Facility, 116th Cong. (Sept. 17, 2020) (Statement of Representative Hill), at 29.
[199] CARES Act, Pub. L. No. 116-136, § 4003(c)(3)(B), 134 Stat. 281 (2020).
[200] Emma G. Fitzsimmons, *M.T.A. Warns of Fare Increases and Service Cuts as Budget Crisis Looms*, New York Times, Nov. 15, 2018, https://www.nytimes.com/2018/11/15/nyregion/mta-fare-hike-nyc.html?module=inline.
[201] *Id.*
[202] Danielle Muoio, *MTA's 'dire fiscal condition' further strained by rising debt load*, Politico, Oct. 13, 2020, https://subscriber.politicopro.com/transportation/article/2020/10/mtas-dire-fiscal-condition-further-strained-by-rising-debt-load-2008234.
[203] Carrie Cohen, Morrison Foerster, *Report of Findings and Recommendations for the Metropolitan Transportation Authority-Overtime Policies and Procedures*, Aug. 15, 2019, https://new.mta.info/document/10001.

> [T]he MTA has not effectively managed and controlled its overtime costs. Rather, there has been a culture of acceptance among MTA managers regarding overtime, and no real efforts were made to make significant changes in longstanding practices that resulted in routine, and often unnecessary, overtime. As a result, overtime has become the rule rather than the exception for many of the MTA's employees, and the MTA's already high overtime costs have continued to escalate.[204]

Senator Toomey further notes that Morrison Foerster's 2019 report observed that the overtime remained a serious and unchecked issue – "[d]espite years of similar warnings, documented findings, and reports of excessive and escalating overtime, management and leadership of the [MTA] have failed to address excessive overtime and have not been held accountable for this failure and the resulting escalating overtime costs."[205] Senator Toomey also underscores that data from the same report shows that the MTA has spent more than $7 billion in questionable and suspicious overtime expenses since 2014 (see Table 1 in Appendix H).[206]

Further, Senator Toomey notes that the MTA's Office of Inspector General has conducted more than 40 investigations into attendance and overtime practices since 2009, and that a 2019 OIG report noted "MTA management lacked the fundamental ability to properly verify overtime claims," which it found "especially troubling" since the MTA had spent 8.5% of its operating budget on overtime in 2018.[207] Moody's also referenced the MTA's "inflexible labor costs" in its recent downgrade of the MTA's revenue bonds in September.[208]

The facility's use restrictions. Dr. Zandi, Mr. Gee, and Mr. McCoy all testified that MLF borrowers should have more flexibility in how they use MLF loan proceeds. Mr. Gee testified that "[t]he needs and strengths of every community differ," and that increasing flexibility for how proceeds may be used would empower "jurisdictions to utilize [the MLF] in ways that best suit their needs, such as undertaking long-overdue capital projects" that "mean job creation and improving the infrastructure of a local economy."[209] Dr. Zandi likewise recommended

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[204] *Id.*
[205] *Id.*
[206] *Id.*
[207] Office of the MTA Inspector General, *Carolyn Pokorny, MTA Inspector General, 2019 Annual Report*, http://mtaig.state.ny.us/assets/pdf/annual/2019.pdf.
[208] Moody's Investors Service, *Rating Action: Moody's downgrades MTA, NY's Transportation Revenue Bonds to A3 from A2; outlook is negative*, Sept. 11, 2020, https://www.moodys.com/research/Moodys-downgrades-MTA-NYs-Transportation-Revenue-Bonds-to-A3-from--PR_906709291.
[209] Congressional Oversight Commission hearing on the Municipal Liquidity Facility, 116th Cong. (Sept. 17, 2020) (Prepared Testimony of Marion Gee, President, GFOA & Finance Director, Metropolitan St. Louis Sewer District), https://coc.senate.gov/sites/default/files/2020-09/MLF%20Testimony%20-%20GEE.pdf.

"permit[ting] MLF funds to be used more broadly,"[210] and Mr. McCoy explained that permitting MLF proceeds to be used for "capital financing" could free up "liquid resources … to address the crisis."[211]

Representative Shalala and Commissioner Ramamurti agree with Dr. Zandi, Mr. Gee, and Mr. McCoy that the Federal Reserve should give state and local governments greater flexibility. In their view, local communities are better equipped to determine whether and how borrowing can help them weather the crisis and recover, and the MLF should be flexible so that it can be a useful option in state and local governments' recovery toolkit. Commissioner Ramamurti further notes that the Federal Reserve's lending facilities for corporations do not have similar cash-flow-only use restrictions.[212]

Senator Toomey and Representative Hill believe that the MLF was not intended to finance long-term capital projects, to serve as stimulus money, or to resolve longstanding budget problems in states. As Mr. Hiteshew of the Federal Reserve testified, the facility's use of proceeds terms are "carefully calibrated to meet the purpose of the program."[213]

The facilities' eligibility rules. In response to Representative Shalala's question why only 250 entities are eligible to directly access the facility (as opposed to via a designation or using a

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[210] Congressional Oversight Commission hearing on the Municipal Liquidity Facility, 116th Cong. (Sept. 17, 2020) (Testimony of Dr. Mark Zandi, Chief Economist, Moody's Analytics), at 66.
[211] Congressional Oversight Commission hearing on the Municipal Liquidity Facility, 116th Cong. (Sept. 17, 2020) (Prepared Testimony of Pat McCoy, Finance Director, Metropolitan Transit Authority), at 4, https://coc.senate.gov/sites/default/files/2020-09/Witness%20Testimony%20McCoy%20Revised.pdf.
[212] Board of Governors of the Federal Reserve System, *Primary Market Corporate Credit Facility Term Sheet,* July 28, 2020, https://www.federalreserve.gov/newsevents/pressreleases/files/monetary20200728a9.pdf; Federal Reserve System, *Secondary Market Corporate Credit Facility Term Sheet*, June 28, 2020, https://www.federalreserve.gov/newsevents/pressreleases/files/monetary20200728a1.pdf; Board of Governors of the Federal Reserve System, *Main Street New Loan Facility Term Sheet*, July 28, 2020, https://www.federalreserve.gov/newsevents/pressreleases/files/monetary20200728a3.pdf; Board of Governors of the Federal Reserve System, *Main Street Priority Loan Facility Term Sheet*, July 28, 2020, https://www.federalreserve.gov/newsevents/pressreleases/files/monetary20200728a2.pdf; Board of Governors of the Federal Reserve System, *Main Street Expanded Loan Facility Term Sheet*, July 28, 2020, https://www.federalreserve.gov/newsevents/pressreleases/files/monetary20200728a5.pdf; Board of Governors of the Federal Reserve System, *Nonprofit Organization New Loan Facility*, July 28, 2020, https://www.federalreserve.gov/newsevents/pressreleases/files/monetary20200728a10.pdf; Board of Governors of the Federal Reserve System, *Nonprofit Organization Expanded Loan Facility*, July 28, 2020, https://www.federalreserve.gov/monetarypolicy/mainstreetlending.htm.
[213] Congressional Oversight Commission hearing on the Municipal Liquidity Facility, 116th Cong. (Sept. 17, 2020) (Testimony of Kent Hiteshew, Deputy Associate Director, Division of Financial Stability, Board of Governors of the Federal Reserve System), at 16.

state as a conduit), Mr. Hiteshew testified that the Federal Reserve had focused on "some of the largest issuers" while excluding others for administrability reasons.[214] Mr. Hiteshew expressed willingness "to work with … the Commission to identify underserved issuers that we might be able to expand the program to serve."[215] Commissioner Ramamurti also noted that "Guam and Puerto Rico and Indian tribes are shut out categorically from [the MLF]," and that "[o]ther criteria like the credit ratings and also the fact that you have to be rated by a national statistical ratings organization are also exclusionary," and inquired whether the Federal Reserve would "commit … to take a fresh look at each of these eligibility restrictions through the lens of whether they serve what Chair Powell called 'the Fed's guiding principles' of inclusion."[216] Mr. Hiteshew responded, "we would be glad to do that."[217]

Mr. Gee and Mr. McCoy testified that eligibility should be expanded. Mr. Gee explained that the criteria "leav[e] out the vast majority of nearly 80,000 public issuers,"[218] that "access should be expanded to a larger, more diverse pool of issuers," and that the gubernatorial designation process is problematic because it "pits local governments against one another even though we are working towards common goals during this crisis."[219] Mr. McCoy further testified that "[e]xpanding the facility to include an expansive network of essential public service providers will help to underpin the infrastructure we use to keep the country running."[220]

Representative Shalala and Commissioner Ramamurti agree that eligibility requirements should be loosened, and that the Federal Reserve should include a more diverse set of borrowers. They note several further considerations and concerns: (1) expanded eligibility should be administratively feasible given the limited program participation to date; (2) there is evidence that using population size as a screen can have a disparate racial impact;[221] and (3) delegating to

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[214] *Id.* at 31-32.
[215] *Id.*
[216] Congressional Oversight Commission hearing on the Municipal Liquidity Facility, 116th Cong. (Sept. 17, 2020) (Statement of Commissioner Bharat Ramamurti), at 24, (paraphrasing *Chair Powell's Remarks on Racial Equality*, June 12, 2020, https://www.stlouisfed.org/news-releases/2020/06/12/chair-powells-remarks-on-racial-equality).
[217] Congressional Oversight Commission hearing on the Municipal Liquidity Facility, 116th Cong. (Sept. 17, 2020) (Testimony of Kent Hiteshew, Deputy Associate Director, Division of Financial Stability, Board of Governors of the Federal Reserve System), at 41.
[218] Congressional Oversight Commission hearing on the Municipal Liquidity Facility, 116th Cong. (Sept. 17, 2020) (Prepared Testimony of Marion Gee, President, GFOA & Finance Director, Metropolitan St. Louis Sewer District), https://coc.senate.gov/sites/default/files/2020-09/MLF%20Testimony%20-%20GEE.pdf.
[219] *Id.*
[220] Congressional Oversight Commission hearing on the Municipal Liquidity Facility, 116th Cong. (Sept. 17, 2020) (Testimony of Mr. Pat McCoy, Finance Director, Metropolitan Transit Authority), at 50.
[221] Aaron Klein & Camille Busette, *Improving the Equity Impact of the Fed's Municipal Lending Facility*, Brookings Institution, Apr. 14, 2020, https://www.brookings.edu/research/a-chance-to-improve-the-equity-impact-of-the-feds-municipal-lending-facility/.

governors designation authority may inappropriately transform what should be an objective assessment of need and merit into a political calculus. Commissioner Ramamurti additionally notes that (1) the Federal Reserve purchased below investment-grade corporate debt in another Section 13(3) program, so Section 13(3) ought not to constrain it from purchasing territorial or tribal debt—particularly given that the CARES Act expressly defines territories and tribes as eligible borrowers;[222] and (2) it is unclear why the Federal Reserve is purely relying on nationally recognized statistical ratings organizations for eligibility, particularly given reliability issues during the last financial crisis.[223]

Senator Toomey and Representative Hill agree with Mr. Hiteshew of the Federal Reserve that the MFL's current eligibility terms are sufficient, as they believe that they allow avenues for all interested issuers to access the market through a conduit process.[224] They note that in addition to a previous change expanding the program to smaller issuers and allowing for gubernatorial designations, the facility permits states and larger cities and counties to act as a conduit to smaller entities to access the MLF.[225] For example, as Mr. Hiteshew explained to Representative Hill, Arkansas or the City of Little Rock, Arkansas "could borrow on behalf of … arenas or entities pursuant to the down-streaming provisions of the original MLF design."[226] As Mr. Hiteshew noted, due to the stabilization of the market resulting from the Federal Reserve's actions, he is not aware of any cities or counties with populations below the MLF eligibility thresholds that cannot access affordable capital.[227]

Secondary market purchases of municipal bonds. In a post-hearing call with the Commission, the Federal Reserve's Office of General Counsel explained that in the Federal Reserve's view, the difference between primary market and secondary market purchases explains the differential interest rates between similarly rated corporate and municipal bonds that the

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222 CARES Act, Pub. L. No. 116-136, §§ 4002(1)(C), (E), 4003(b)(4), 134 Stat. 281 (2020).
223 *E.g.*, Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub. L. No. 111-203, §§ 939-939A, 124 Stat. 1376.
224 Congressional Oversight Commission hearing on the Municipal Liquidity Facility, 116th Cong. (Sept. 17, 2020) (Testimony of Kent Hiteshew, Deputy Associate Director, Division of Financial Stability, Board of Governors of the Federal Reserve System), at 19 and 20.
225 *Id.*
226 Congressional Oversight Commission hearing on the Municipal Liquidity Facility, 116th Cong. (Sept. 17, 2020) (Statement of Representative Hill), at 45.
227 *Id.*; Congressional Oversight Commission hearing on the Municipal Liquidity Facility, 116th Cong. (Sept. 17, 2020) (Prepared Testimony of Kent Hiteshew, Deputy Associate Director, Division of Financial Stability, Board of Governors of the Federal Reserve System), at 4 and 5, https://coc.senate.gov/sites/default/files/2020-09/MLF%20Testimony%20-%20HITESHEW_0.pdf.

Federal Reserve has purchased—that is, the differentials Commissioner Ramamurti raised at the hearing.[228]

The General Counsel explained that the Federal Reserve does not interpret Regulation A's penalty-rate provision as applying to secondary market purchases (of any type), and that accordingly SMCCF purchases need not be at a penalty rate. In contrast, the General Counsel explained, primary market purchases (of any type) are subject to this requirement. To date, the Federal Reserve has made two primary market purchases of municipal bonds (via the MLF) but has not established a facility for secondary market purchases of municipal bonds. It has made secondary market purchases of corporate bonds (via the SMCCF) and purchased loans made by banks to small-to-medium-sized businesses (via the MSLP).

The full Commission recommends that the SMCCF cease making any purchases. Given the Federal Reserve's success in buoying corporate bond markets, and recognizing that primary market investment-grade corporate bond rates are now below pre-pandemic levels, the Commission does not believe that further secondary market corporate bond purchases through the SMCCF are necessary. Views differ, however, regarding whether the Federal Reserve should create a facility for secondary market purchases of municipal bonds.

At the hearing, when asked why the Federal Reserve has not established a secondary market facility for municipal bonds, Mr. Hiteshew testified that "every day we are talking to market participants, and … [t]hey do not believe a secondary market facility in munis at this time is necessary."[229] He further testified that the Commercial Paper Funding Facility ("CPFF") and MMLF had "enormously positive impact" in the secondary municipal market; that the municipal market is "idiosyncratic … and relative[ly] illiquid[] … compared to corporates;" and when asked by Representative Hill whether closed-end funds would be an effective way to participate in the secondary municipal markets, Mr. Hiteshew noted that "[m]unis … have very little ETFs …, and the secondary market for corporates is largely being executed through the purchases of ETFs."[230]

Senator Toomey and Representative Hill agree with Mr. Hiteshew's assessment that a secondary market municipal bond facility is not currently necessary. Mr. Hiteshew noted that

[228] Congressional Oversight Commission hearing on the Municipal Liquidity Facility, 116th Cong. (Sept. 17, 2020) (Statement of Commissioner Bharat Ramamurti), at 22 and 24 (contrasting rates of Chevron and Philip Morris bonds with prospective rates of states with same credit rating).
[229] Congressional Oversight Commission hearing on the Municipal Liquidity Facility, 116th Cong. (Sept. 17, 2020) (Testimony of Kent Hiteshew, Deputy Associate Director, Division of Financial Stability, Board of Governors of the Federal Reserve System), at 21.
[230] *Id.* at 20-21 and 42.

during the market disruption of March 2020, "we were driven by what we were hearing from state and local issuers—get liquidity available as soon as possible, and we wanted to do that and also restore market confidence. We thought that designing a secondary market program for munis would have taken longer."[231] Senator Toomey and Representative Hill agree that the Federal Reserve took unprecedented measures to restore confidence in the municipal bond markets which allowed issuers to access credit at levels below pre-COVID-19 levels without the need of a secondary market facility (see Chart 5 in Appendix H).[232] Further, Mr. Hiteshew agreed that the MMLF "had an enormously positive impact" and that "in terms of the secondary market, we are very cognizant of the differences in the markets, and munis are very different than corporates, as I think everybody here understands."[233]

Further, Senator Toomey and Representative Hill note that state and local governments have been able to access credit in the private markets and they do not need further government support to finance their debt. They note that through September, municipal bond issuance has totaled $347 billion, a 23.6% increase from the same period in 2019.[234] In their view, the Federal Reserve has been successful in calming the secondary market for both corporate and municipal bonds without the need of a secondary municipal bond facility (see Chart 6 in Appendix H).[235]

However, during the hearing, Mr. Gee called on the Federal Reserve to "create a facility to provide relief by purchasing municipal securities in the secondary market, similar to the secondary purchasing program in the Secondary Market Corporate Credit Facility."[236] He noted that continuing "uncertainty … regarding the duration of the COVID-19 pandemic and … a second wave of infections … may create a replay" of the March "cash-crunch and selloff in the

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[231] *Id.*
[232] Bloomberg, *AAA General Obligation Municipal BVAL Curve Three-Year Notes,* Jan. 1, 2020 through Sept. 28, 2020, retrieved Sept. 29, 2020 from Bloomberg terminal.
[233] Congressional Oversight Commission hearing on the Municipal Liquidity Facility, 116th Cong. (Sept. 17, 2020) (Testimony of Kent Hiteshew, Deputy Associate Director, Division of Financial Stability, Board of Governors of the Federal Reserve System), at 20-21.
[234] Securities Industry and Financial Markets Association, *U.S. Municipal Issuance XLS*, Oct. 5, 2020, https://www.sifma.org/resources/research/us-municipal-issuance/.
[235] Bloomberg, *AAA General Obligation Municipal BVAL Curve Five-Year Notes, U.S. Composite AAA BVAL Corporate Curve Five-Year Notes,* Jan. 1, 2020 through Oct. 8, 2020, retrieved Oct. 9, 2020 from Bloomberg terminal.
[236] Congressional Oversight Commission hearing on the Municipal Liquidity Facility, 116th Cong. (Sept. 17, 2020) (Testimony of Mr. Marion Gee, President, GFAO & Finance Director, Metropolitan St. Louis Sewer District, Missouri), at 56.

municipal market."[237] Accordingly, "[d]eveloping a special purpose vehicle aimed at purchasing municipal securities and thus providing relief to the secondary market should be considered."[238]

Representative Shalala and Commissioner Ramamurti note this view was recently echoed by a non-partisan coalition that collectively represents tens of thousands of state and local governments.[239] This coalition notes that "[a]t a minimum, having [a secondary market municipal securities facility] developed in advance and at the ready to begin purchasing in the event of a second market selloff would rapidly provide much needed stability to [the] fragile [municipal] markets."[240] In noting that "such a facility is in line with the congressional intent of Title IV of the CARES Act (P.L. 116-136)," the coalition cites bipartisan letters by signed by members of both chambers of Congress in support of the creation of a facility to purchase municipal securities in the secondary market.[241] Other members of Congress and representatives of underwriters and advisers have also previously called for such a facility.[242]

Representative Shalala and Commissioner Ramamurti agree that the Federal Reserve should purchase municipal bonds in the secondary market. They note that the MMLF and CPFF support only notes with even shorter maturities than the MLF,[243] and that the Federal Reserve's

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[237] Congressional Oversight Commission hearing on the Municipal Liquidity Facility, 116th Cong. (Sept. 17, 2020) (Prepared Testimony of Marion Gee, President, GFOA & Finance Director, Metropolitan St. Louis Sewer District), https://coc.senate.gov/sites/default/files/2020-09/MLF%20Testimony%20-%20GEE.pdf.
[238] *Id.*
[239] Letter from Government Finance Officers Association; International City/County Management Association; National Association of Counties, National Association of State Auditors, Comptrollers and Treasurers; National Association of State Treasurers; National League of Cities; and The United States Conference of Mayors to Chair Jerome Powell and Secretary Steven T. Mnuchin, dated Oct. 14, 2020, https://gfoaorg.cdn.prismic.io/gfoaorg/55818178-59da-41f8-ba44-383849bc85ed_MLFCoalitionLetter_FINAL.pdf.
[240] *Id.*
[241] *Id.* (citing Letter from Senators Menendez, Brown, Tillis, & Murkowski to Chair Jerome Powell and Secretary Steven T. Mnuchin, dated May 14, 2020, https://www.menendez.senate.gov/imo/media/doc/05142020%20Letter%20to%20Treasury%20and%20Federal%20Reserve%20re%20Municipal%20Lending.pdfL; Letter from Congressman Steve Stivers, Dutch Ruppersberger et. al. to Chair Jerome Powell and Secretary Steven T. Mnuchin, dated May 1, 2020, https://www.ncsha.org/wp-content/uploads/Stivers-Ruppersberger-Letter-to-FED-Treausry-5.1.2020.pdf).
[242] American Securities Association, *ASA Applauds Chairwoman Waters Urging Fed to Further Help Main Street*, Apr. 17, 2020, https://www.americansecurities.org/post/asa-applauds-chairwoman-waters-urging-fed-to-further-help-main-street; Letter from the Chairwoman of the U.S. House Committee on Financial Services to Chair Jerome H. Powell, dated Apr. 16, 2020, https://financialservices.house.gov/uploadedfiles/ltr_to_fed_on_facilities_041620.pdf.
[243] Board of Governors of the Federal Reserve, *Commercial Paper Funding Facility: Program Terms and Conditions*, July 23, 2020, https://www.federalreserve.gov/monetarypolicy/files/monetary20200723a1.pdf (3-month commercial paper); Board of Governors of the Federal Reserve, *Money Market Mutual Fund Liquidity Facility: Program Terms and Conditions*, July 28, 2020,

corporate secondary market purchases broadly drove primary-market corporate bond rates below pre-pandemic levels. In contrast, many primary-market municipal bond rates (including those of the MTA and Illinois) are currently higher. They further note that municipal spreads to Treasuries remain elevated. They are unpersuaded by Mr. Hiteshew's suggestion that the secondary municipal market is too thin or illiquid to support secondary market purchases, as primary dealers currently hold about $12 billion in municipal bonds,[244] the secondary market's September volume was $218 billion,[245] and the Federal Reserve treats municipal obligations as "high-quality liquid assets."[246] They further note that the SMCCF currently purchases an index of individual corporate bonds, not ETFs.[247]

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https://www.federalreserve.gov/newsevents/pressreleases/files/monetary20200728a4.pdf (maturities under 12 months).

[244] Federal Reserve Bank of New York, *Primary Dealer Statistics*, https://www.newyorkfed.org/markets/gsds/search (last visited Sept. 22, 2020).

[245] PIMCO, *Monthly Municipal Market Update, September 2020*, Oct. 14, 2020, https://www.pimco.com/en-us/insights/investment-strategies/munis-and-the-markets/monthly-municipal-market-update-september-2020.

[246] Office of the Comptroller of the Currency, Treasury, Board of Governors of the Federal Reserve System, & Federal Deposit Insurance Corporation, *Liquidity Coverage Ratio Rule: Treatment of Certain Municipal Obligations as High-Quality Liquid Assets*, 84 Fed. Reg. 25975-01 (June 5, 2019).

[247] Board of Governors of the Federal Reserve System, *SMCCF Transaction-specific Disclosures*, Sept. 8, 2020, https://www.federalreserve.gov/publications/files/smccf-transaction-specific-disclosures-9-8-20.xlsx.

TREASURY AND FEDERAL RESERVE RECENT DEVELOPMENTS

In August and September 2020, the Treasury and the Federal Reserve took a number of actions under Division A, Title IV, Subtitle A of the CARES Act. We describe the key recent developments below.

Primary Market Corporate Credit Facility ("PMCCF")

As of October 9, 2020, the Federal Reserve had yet to announce that the PMCCF had actually purchased any bonds or syndicated loans.

Secondary Market Corporate Credit Facility ("SMCCF")

As of September 28, 2020, the SMCCF had purchased corporate bonds from more than 500 different issuers.[248] The amortized cost for these bonds was $4.38 billion.[249] The chart below lists the SMCCF's 10 largest individual bond holdings by issuer as of September 28, 2020.[250] The bonds of these 10 issuers make up 15.6% of the SMCCF's total individual bond holdings.

Issuer	Sector	Amortized Cost (U.S. $ Million)	Percentage of SMCCF's Individual Bond Holdings
AT&T Inc.	Communications	$78.0	1.8%
Volkswagen Group of America Finance LLC	Consumer Cyclical	77.5	1.8%
Toyota Motor Credit Corp.	Consumer Cyclical	76.0	1.7%
Daimler Finance North America LLC	Consumer Cyclical	74.3	1.7%
Verizon Communications Inc.	Communications	73.6	1.7%
Apple Inc.	Technology	69.2	1.6%
Comcast Corp.	Communications	64.8	1.5%
General Electric Co.	Capital Goods	61.4	1.4%

[248] Board of Governors of the Federal Reserve System, *Periodic Report: Update on Outstanding Lending Facilities Authorized by the Board under Section 13(3) of the Federal Reserve Act (Transaction-specific Disclosures)*, Oct. 8, 2020, https://www.federalreserve.gov/publications/files/smccf-transaction-specific-disclosures-10-8-20.xlsx;
[249] *Id*.
[250] *Id*.

Issuer	Sector	Amortized Cost (U.S. $ Million)	Percentage of SMCCF's Individual Bond Holdings
BMW US Capital LLC	Consumer Cyclical	56.9	1.3%
Microsoft Corp.	Technology	53.2	1.2%

As of September 28, 2020, the SMCCF had purchased 112.8 million shares of bond ETFs.[251] The facility made no bond ETFs purchases since its July 30, 2020 disclosure.[252] The SMCCF has purchased shares from 16 bond ETFs with a market value of $8.62 billion as of September 28, 2020.[253] Of these holdings, the nine investment-grade ETFs totaled 87% of market value and the seven non-investment-grade ETFs totaled 13% of the market value. [254]

The chart below lists the names of the bond ETFs that the SMCCF has purchased, the number of shares purchased, and the market value of those shares as of September 30, 2020.

Name of ETF	Shares Purchased	Market Value (U.S. $ Billion)
iShares iBoxx US Dollar Investment Grade Corporate Bond ETF	17,860,663	$2.41
Vanguard Short-Term Corporate Bond ETF	18,237,015	1.51
Vanguard Intermediate-Term Corporate Bond ETF	14,875,069	1.43
iShares Short-Term Corporate Bond ETF	12,448,466	0.68
SPDR Bloomberg Barclays High Yield Bond ETF	5,285,048	0.55

[251] *Id.*
[252] Board of Governors of the Federal Reserve System, *Periodic Report: Update on Outstanding Lending Facilities Authorized by the Board under Section 13(3) of the Federal Reserve Act (Transaction-specific Disclosures)*, Oct. 8, 2020, https://www.federalreserve.gov/publications/files/smccf-transaction-specific-disclosures-10-8-20.xlsx; Board of Governors of the Federal Reserve System, *Periodic Report: Update on Outstanding Lending Facilities Authorized by the Board under Section 13(3) of the Federal Reserve Act (Transaction-specific Disclosures)*, Oct. 8, 2020, https://www.federalreserve.gov/publications/files/smccf-transaction-specific-disclosures-10-8-20.xlsx.
[253] *Id.*
[254] *Id.*

Name of ETF	Shares Purchased	Market Value (U.S. $ Billion)
iShares Intermediate-Term Corporate Bond ETF	8,046,720	0.49
SPDR Portfolio Intermediate Term Corporate Bond ETF	13,181,447	0.48
iShares iBoxx High Yield Corporate Bond ETF	3,875,790	0.33
SPDR Portfolio Short Term Corporate Bond ETF	8,954,460	0.28
iShares Broad US Dollar Investment Grade Corporate Bond ETF	2,997,120	0.18
Xtrackers US Dollar High Yield Corporate Bond ETF	1,644,970	0.08
iShares Broad US Dollar High Yield Corporate Bond ETF	1,555,865	0.06
iShares 0-5 Year Investment Grade Corporate Bond ETF	841,975	0.04
VanEck Vectors Fallen Angel High Yield Bond ETF	1,129,770	0.03
SPDR Bloomberg Barclays Short Term High Yield Bond ETF	1,220,506	0.03
iShares 0-5 Year High Yield Corporate Bond ETF	685,850	0.03

On October 5, 2020, the Federal Reserve announced a competitive procurement process for a vender to manage the reinvestment of cash flows generated by the SMCCF and PMCCF.[255]

In this report, the Congressional Oversight Commission recommends that the SMCCF cease making any purchases. Given the Federal Reserve's success in buoying corporate bond markets, and that primary market investment-grade corporate bond rates are now below pre-pandemic levels, the Commission does not believe further secondary market corporate bond purchases through the SMCCF are necessary.

[255] The Federal Reserve Bank of New York, *New York Fed Begins Competitive Procurement Process for Certain Vendor Roles Supporting Emergency Lending Facilities and Programs*, Oct. 5, 2020, https://www.newyorkfed.org/newsevents/news/markets/2020/20201005.

Main Street Lending Program ("MSLP")

On August 24, 2020 and September 18, 2020, the Federal Reserve provided updated guidance regarding the MSLP's for-profit business facilities, including updates regarding the new allowance of multi-borrower loans and certain operational details of the program.[256] Notably, the guidance issued on September 18, 2020 indicates that the Federal Reserve is no longer considering expanding the program to include non-cash flow based lending options, such as asset-based lending,[257] and changed the criteria from the lender's "own underwriting standards" to an assessment of the borrower's "pre-pandemic financial condition and post-pandemic prospects, taking into account the payment deferral features" of the loans.[258] It also provides that loans made by a borrower to an owner are presumptively prohibited capital distributions, but that certain "bona fide" loans may overcome that presumption.[259]

On September 4, 2020, the Federal Reserve announced that the MSLP's nonprofit facilities were fully operational.[260] The Federal Reserve provided updated guidance regarding the MSLP's nonprofit facilities on September 4, 2020 and September 18, 2020 which, among other things, also relaxed underwriting standards for loans to nonprofit organizations by changing the criteria from the lender's "own underwriting standards" to an assessment of the borrower's "pre-pandemic financial condition and post-pandemic prospects, taking into account the payment deferral features" of the loans.[261]

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[256] Board of Governors of the Federal Reserve System, *Main Street Lending Program For-Profit Businesses Frequently Asked Questions,* Aug. 24, 2020, https://www.federalreserve.gov/monetarypolicy/mainstreetlending.htm; Board of Governors of the Federal Reserve System, *Main Street Lending Program For-Profit Businesses Frequently Asked Questions,* Sept. 18, 2020, https://www.federalreserve.gov/monetarypolicy/mainstreetlending.htm.
[257] Board of Governors of the Federal Reserve System, *Main Street Lending Program For-Profit Businesses Frequently Asked Questions,* Sept. 18, 2020, at 28, https://www.federalreserve.gov/monetarypolicy/mainstreetlending.htm.
[258] *Id.* at 32, 58.
[259] *Id*. at 53-54.
[260] The Federal Reserve Bank of Boston, *Fed's Main Street Lending Program is now fully operational for loans to nonprofit organizations,* Sept. 4, 2020, https://www.bostonfed.org/news-and-events/press-releases/2020/feds-main-street-lending-program-is-now-fully-operational-for-loans-to-nonprofit-organizations.aspx?utm_source=email-alert&utm_medium=email&utm_campaign=mslp&utm_content=mslp-pr-200904.
[261] Board of Governors of the Federal Reserve System, *Main Street for Nonprofit Organizations Frequently Asked Questions*, Sept. 4, 2020, https://www.bostonfed.org/-/media/Documents/special-lending-facilities/mslp/legal/frequently-asked-questions-faqs-nonprofit.pdf?la=en; Board of Governors of the Federal Reserve System, *Main Street for Nonprofit Organizations Frequently Asked Questions*, Sept. 18, 2020, at 30, 50, https://www.bostonfed.org/-/media/Documents/special-lending-facilities/mslp/legal/frequently-asked-questions-faqs-nonprofit.pdf?la=en.

As of September 30, 2020, eligible lenders made 252 loans through the MSLP.[262] These loans totaled $2.3 billion, with $2.2 billion in Federal Reserve participation.[263] Businesses in 36 states participated in the program, led by Florida with 21.1%, followed by Texas with 17.2%, California with 9.5%, and Pennsylvania with 7.4% of the loan proceeds.[264] Loans' sizes ranged from $250,000 to $71.1 million, and included a wide range of sectors, from yoga studios to oil and gas companies.[265] Nearly two-fifths of the loans were issued by one bank, City National Bank of Florida, representing nearly a quarter of total loan proceeds. The Commission is in the process of contacting that bank to learn more about its experience with the MSLP.

Secretary Steven Mnuchin testified on September 1, 2020 before the House of Representatives' Select Subcommittee on the Coronavirus Crisis that he anticipated the MSLP will extend between $25 billion and $50 billion total in loans through the life of the program.[266] On September 29, 2020, the Federal Reserve released a supplementary Senior Loan Officer Opinion Survey covering the MSLP, which found, among other things, that "only a modest share of banks expected their willingness to extend MSLP loans to increase" in the next three months.[267] The survey also found that 10% of respondent banks currently registered for the MLSP said they would make MSLP loans only if macroeconomic conditions deteriorated.[268] Another 4% who are not currently registered said they would likely register for the MSLP if conditions deteriorated.[269] Banks registered to participate in the program cited as reasons for not approving MSLP loans that "the borrower was already in poor financial condition before the COVID-19 crisis, the borrower was too severely affected by the crisis to remain viable and repay the loan, key loan terms were not attractive or prevented the borrower from qualifying, and the borrowers' planned use of the MSLP loan was not financially sound."[270]

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262 Board of Governors of the Federal Reserve System, *Periodic Report: Update on Outstanding Lending Facilities Authorized by the Board under Section 13(3) of the Federal Reserve Act (Transaction-specific Disclosures)*, Oct. 8, 2020, https://www.federalreserve.gov/publications/files/mslp-transaction-specific-disclosures-10-8-20.xlsx.
263 *Id*.
264 *Id*.
265 *Id*.
266 U.S. House of Representatives Select Subcommittee on the Coronavirus Crisis hearing with Treasury Secretary Steven T. Mnuchin, 116th Cong. (Sept. 1, 2020) (testimony of Steven T. Mnuchin, Secretary, U.S. Department of the Treasury).
267 Board of Governors of the Federal Reserve System, *September 2020 Senior Loan Officer Opinion Survey on Bank Lending Practices*, Sept. 29, 2020, https://www.federalreserve.gov/data/sloos/sloos-202009.htm.
268 *Id.*
269 *Id.*
270 *Id.*

Municipal Liquidity Facility ("MLF")

To date, the Federal Reserve has purchased only two notes through the MLF – one from the state of Illinois, and the other from New York's Metropolitan Transportation Authority ("MTA").[271] On June 5, 2020, Illinois borrowed $1.2 billion from the MLF through the sale of a one-year note, making it the facility's first participant.[272] Illinois will pay an interest rate of 3.36% on this note.[273] On August 18, 2020, the MTA, which runs the largest transit system in the United States, borrowed $450.7 million from the MLF through the sale of a three-year note.[274] The MTA will pay the MLF 1.93% on the note.[275]

On September 8, 2020, the Federal Reserve provided updated guidance regarding notes that have "split ratings" (meaning, different ratings from different credit rating agencies), which could increase a note's pricing by 0.50% under certain circumstances.[276]

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[271] Board of Governors of the Federal Reserve System, *Periodic Report: Update on Outstanding Lending Facilities Authorized by the Board under Section 13(3) of the Federal Reserve Act (Transaction-specific Disclosures)*, Oct. 8, 2020, https://www.federalreserve.gov/publications/files/mlf-transaction-specific-disclosures-10-8-20.xlsx; Karen Pierog & Jonnelle Marte, *New York transit agency turns to Fed for $450 million borrowing*, Reuters, Aug. 18, 2020, https://www.reuters.com/article/us-usa-newyork-fed-debt/new-york-transit-agency-turns-to-fed-for-450-million-borrowing-idUSKCN25E2R3.

[272] Shruti Singh & Amanda Albright, *Illinois Becomes First to Tap Fed Loans After Yields Surge*, Bloomberg, June 2, 2020, https://www.bloomberg.com/news/articles/2020-06-02/illinois-becomes-first-to-tap-fed-loans-after-bond-yields-surge.

[273] Board of Governors of the Federal Reserve System, *MLF Transaction-specific Disclosures*, Oct. 8, 2020, https://www.federalreserve.gov/publications/files/mlf-transaction-specific-disclosures-10-8-20.xlsx. Illinois reportedly was originally set to pay 3.82% on its 1-year note. *See* Shruti Singh & Amanda Albright, *Illinois Becomes First to Tap Fed Loans After Yields Surge,* Bloomberg, June 2, 2020, https://www.bloomberg.com/news/articles/2020-06-02/illinois-becomes-first-to-tap-fed-loans-after-bond-yields-surge. It appears that the revision stems from the Federal Reserve applying its revised pricing retroactively. *See* Board of Governors of the Federal Reserve, *Municipal Liquidity Facility Term Sheet*, Aug. 11, 2020, https://www.federalreserve.gov/newsevents/pressreleases/files/monetary20200811a1.pdf (revised term sheet providing that "An Eligible Issuer that has issued Eligible Notes to the SPV may elect to reprice such Eligible Notes based on pricing revisions to Appendix B. The new pricing will be based on the applicable ratings at the time of the repricing.").

[274] Karen Pierog & Jonnelle Marte, *New York transit agency turns to Fed for $450 million borrowing*, Reuters, Aug. 18, 2020, https://www.reuters.com/article/us-usa-newyork-fed-debt/new-york-transit-agency-turns-to-fed-for-450-million-borrowing-idUSKCN25E2R3; Amanda Albright & Danielle Moran, *New York's MTA Becomes Second to Tap Fed as Banks Demand Higher Yields,* Bloomberg, Aug. 18, 2020, https://www.bloomberg.com/news/articles/2020-08-18/ny-mta-becomes-second-to-tap-fed-as-banks-demand-higher-yields?srnd=economics-vp&sref=hKSAni5g.

[275] Board of Governors of the Federal Reserve System, *MLF Transaction-specific Disclosures*, Oct. 8, 2020, https://www.federalreserve.gov/publications/files/mlf-transaction-specific-disclosures-10-8-20.xlsx.

[276] *See* Federal Reserve Bank of New York, *FAQs: Municipal Liquidity Facility*, Sept. 8, 2020, https://www.newyorkfed.org/markets/municipal-liquidity-facility/municipal-liquidity-facility-faq ("If the credit has

On October 6, 2020, The Federal Reserve Bank of New York announced a deadline for eligible issuers to submit letters of intent to the MLF of no later than 30 days prior to the MLF's December 31, 2020 expiration.[277]

Term Asset-Backed Securities Loan Facility ("TALF")

On October 8, 2020, the Federal Reserve disclosed transaction-specific data about the TALF's activities through September 30, 2020.[278] As of September 30, 2020, the TALF had made 186 loans totaling $3.2 billion to 19 different borrowers.[279] Of the $3.2 billion in total loans, as illustrated in the chart below, 55% was backed by small business loans, 34% was backed by commercial mortgage loans, 8% was backed by student loans, and 3% was backed by premium finance.[280]

By Collateral Sector	Loan Amount (U.S. $ Billion)	% of Total
Small Business	$1.8	55%
Commercial Mortgage	1.1	34%
Student Loans	0.263	8%
Premium Finance	0.107	3%
Total	**$3.24**	**100%**

different ratings (i.e., 'split ratings'), the applicable spread will be determined by calculating an average of all of the confirmed ratings" and "will be increased by 50 bps if the spread corresponding to the lowest rating of the credit for the Eligible Notes is more than 50 bps above the spread corresponding to the average rating of the credit for the Eligible Notes.").

277 Federal Reserve Bank of New York, *New York Fed Announces Notice of Interest Deadline for Municipal Liquidity Facility*, Oct. 6, 2020, https://www.newyorkfed.org/newsevents/news/markets/2020/20201006.

278 Board of Governors of the Federal Reserve System, *TALF Transaction-specific disclosures*, Oct. 8, 2020, https://www.federalreserve.gov/publications/files/talf-transaction-specific-disclosures-10-8-20.xlsx.

279 *Id.*

280 *Id.*

As of September 30, 2020, the five borrowers to whom the TALF has lent the most money are as follows:[281]

Borrower	Total Amount of Loans (in $ billions)
Alta Fundamental Advisors SP LLC-Belstar-Alta Series 1	$1.34
Mackay Shields TALF 2.0 Opportunities Master Fund LP	0.81
Palmer Square TALF Opportunity Sub LLC	0.22
Alta Fundamental Advisors SP LLC-Belstar-Alta Series 2	0.17
Blackrock Securitized Investors, L.P.	0.11

Treasury Loans for the Airline Industry and National Security Businesses

The Treasury has $17 billion available to make loans to businesses critical to maintaining national security under Subtitle A. To date, it has provided a national security loan to only one business—YRC Worldwide Inc ("YRC"). On July 8, 2020, the Treasury finalized a $700 million loan to YRC.[282] On August 7, 2020, the Commission submitted questions to Secretary Mnuchin and Secretary Esper regarding this loan, requesting responses by August 27, 2020. On August 27, 2020, the Treasury sent the Commission a letter (attached to this report) stating that it is "working actively to respond … as quickly as possible" and that it expected to be able to provide the Commission with its responses by September 4, 2020. On September 4, 2020, the Treasury provided the response and initial document disclosures attached to this report as Appendix B. The Commission and Treasury are in the process of coordinating the production of additional document disclosures. The Department of Defense also sent a letter, dated September 2, 2020 (attached to this report), stating that it expected to respond to the Commission's questions by September 18, 2020. The Department of Defense missed this deadline and—as of October 15, 2020—the Commission has yet to receive a response. Nor has the Commission received a response to its follow-up inquiry as to when the Department of Defense's response will be sent.

In addition, the Treasury has available $29 billion to make loans to the airline industry under Subtitle A. In July 2020, the Treasury announced that it signed letters of intent with ten passenger air carriers that set out the terms on which the Treasury is prepared to extend loans to

[281] Board of Governors of the Federal Reserve System, *TALF Transaction-specific disclosures*, Oct. 8, 2020, https://www.federalreserve.gov/publications/files/talf-transaction-specific-disclosures-10-8-20.xlsx.
[282] U.S. Department of the Treasury, *Loans to Air Carriers, Eligible Businesses, and National Security Businesses*, last visited Aug. 15, 2020, https://home.treasury.gov/policy-issues/cares/preserving-jobs-for-american-industry/loans-to-air-carriers-eligible-businesses-and-national-security-businesses.

these carriers.[283] Since then, three of the 10 carriers announced that they would not participate in the loan program through the Treasury: Southwest Airlines Co.,[284] Delta Air Lines, Inc.,[285] and Spirit Airlines, Inc.[286]

On September 29, 2020, the Treasury announced that it had closed loans to seven large passenger air carriers: Alaska Airlines, American Airlines, Frontier Airlines, JetBlue Airways, Hawaiian Airlines, SkyWest Airlines, and United Airlines.[287] The Commission is currently in the process of reviewing these loans, which are anticipated to total approximately $14.66 billion.[288]

Borrower	City	State	Total Anticipated Loan Amount
JetBlue Airways Corporation	Long Island City	NY	$1,140,000,000
SkyWest Airlines, Inc.	St. George	UT	$573,000,000
American Airlines, Inc.	Fort Worth	TX	$5,477,000,000
Alaska Airlines, Inc.	Seattle	WA	$1,301,000,000
Hawaiian Airlines, Inc.	Honolulu	HI	$420,000,000
United Airlines, Inc.	Chicago	IL	$5,170,000,000
Frontier Airlines, Inc.	Denver	CA	$574,000,000

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283 U.S. Department of the Treasury, *Statement from Secretary Steven T. Mnuchin on CARES Act Loans to Major Airlines*, July 2, 2020, https://home.treasury.gov/news/press-releases/sm1054.
284 Southwest Airlines Co., *Current Report (Form 8-K)*, Aug. 19, 2020, http://www.southwestairlinesinvestorrelations.com/~/media/Files/S/Southwest-IR/20200819_8K%20Investor%20update_vF.pdf.
285 Delta Air Lines, Inc., *Current Report (Form 8-K)*, Sept. 14, 2020, https://www.sec.gov/ix?doc=/Archives/edgar/data/27904/000119312520244688/d27099d8k.htm.
286 Spirit Airlines, Inc., *Spirit Airlines Announces Closing of Private Offering by Loyalty and Brand Subsidiaries*, Sept. 17, 2020, https://ir.spirit.com/news-releases/news-details/2020/Spirit-Airlines-Announces-Closing-of-Private-Offering-by-Loyalty-and-Brand-Subsidiaries/default.aspx.
287 U.S. Department of the Treasury, *Treasury Concludes Loans to Seven Major Airlines, Supports Additional Relief for Aviation Industry Workers*, Sept. 29, 2020, https://home.treasury.gov/news/press-releases/sm1140.
288 U.S. Department of the Treasury, *Loans to Air Carriers, Eligible Businesses, and National Security Businesses*, https://home.treasury.gov/policy-issues/cares/preserving-jobs-for-american-industry/loans-to-air-carriers-eligible-businesses-and-national-security-businesses (last accessed Oct. 5, 2020).

Appendix A:
Letter from Treasury Department to Congressional Oversight Commission, dated August 27, 2020

DEPARTMENT OF THE TREASURY
WASHINGTON, D.C. 20220

August 27, 2020

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

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

Mr. Bharat Ramamurti
Commissioner
Washington, DC 20515

The Honorable Pat Toomey
United States Senate
Washington, DC 20510

Dear Members of the Congressional Oversight Commission:

I write regarding your August 7, 2020 letter, which requests additional information about the loans the Department of the Treasury agreed to make to YRC Worldwide Inc. (YRC) under section 4003(b)(3) of the Coronavirus Aid, Relief, and Economic Security Act. As your letter acknowledges, Treasury proactively provided the Commission with information on the YRC loans in a letter dated July 30, 2020, and we welcome the opportunity to further inform your work.

Treasury is actively working to respond to the specific questions set forth in your August 7 letter as quickly as possible. We expect to be able to provide the Commission with those responses by September 4.

If you have further questions, please direct your staff to contact the Office of Legislative Affairs

Sincerely,

Frederick W. Vaughan
Principal Deputy Assistant Secretary
for Legislative Affairs

Appendix B:
Letter from Treasury Department to Congressional Oversight Commission, dated September 4, 2020

DEPARTMENT OF THE TREASURY
WASHINGTON, D.C. 20220

September 4, 2020

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

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

Mr. Bharat Ramamurti
Commissioner
Washington, DC 20515

The Honorable Pat Toomey
United States Senate
Washington, DC 20510

Dear Members of the Congressional Oversight Commission:

I write in response to your August 7, 2020 letter, which requests additional information about the loans the Department of the Treasury agreed to make to YRC Worldwide Inc. (YRC) under section 4003(b)(3) of the Coronavirus Aid, Relief, and Economic Security Act. In the spirit of transparency and cooperation, Treasury proactively provided the Commission with information on the YRC loans in a letter dated July 30, 2020, and we welcome the opportunity to further inform your work.

To these ends, we are enclosing responses to the follow-up questions in your August 7 letter, as well as documents we have identified as responsive to your inquiries. In addition, we are coordinating with Commission staff on the production of additional responsive documents that contain sensitive, nonpublic information and should be handled in a confidential manner.

If you have further questions, please direct your staff to contact the Office of Legislative Affairs

Sincerely,

Frederick W. Vaughan
Principal Deputy Assistant Secretary
Office of Legislative Affairs

Enclosures

Appendix: Responses to Questions Included in the Congressional Oversight Commission's August 7, 2020 Letter to the U.S. Department of the Treasury

1. **What was the Treasury's rationale for determining that YRC is critical to maintaining national security? Please provide all documentation and analysis supporting the Treasury's conclusion, including the Secretary of Defense's recommendation and certification that YRC is critical to maintaining national security.**

   Section 4003(b)(3) of the CARES Act authorizes Treasury to make loans and loan guarantees for "businesses critical to maintaining national security." The statute, however, does not define that term. Therefore, Treasury issued guidance on April 10, 2020, providing that a company can fall within this definition if it meets at least one of three criteria at the time of the business's application[1]:

   - the business performs under a "DX"-priority rated contract or order under the Defense Priorities and Allocations System regulations (15 CFR part 700);
   - the business operates under a valid top secret facility security clearance under the National Industrial Security Program regulations (32 CFR part 2004); or
   - based on a recommendation and certification by the Secretary of Defense or the Director of National Intelligence that the applicant business is critical to maintaining national security, the Secretary of the Treasury determines that the applicant business is critical to maintaining national security.

   In accordance with Treasury's guidance, the Secretary of Defense delivered to Treasury a recommendation and certification that YRC is critical to maintaining national security. YRC carries 68 percent of the Department of Defense's less-than-truckload shipments and is the leading transportation provider to the Department of Homeland Security and U.S. Customs and Border Protection. The Secretary of the Treasury determined that YRC is critical to maintaining national security based upon the Secretary of Defense's recommendation and certification.

   A copy of the recommendation and certification by the Secretary of Defense is attached.

2. **Please summarize the decision-making process related to YRC's designation as a business critical to maintaining national security. The summary should (1) identify the parties that were involved in the designation, whether the parties are governmental or otherwise (although the list may elect to use parties' offices, titles, and affiliations while omitting their individual names), and (2) list any department, agency, office, or instrumentality of the United States or entity possessing public authority under the laws of the United States that was included in giving any input into that decision-making process (irrespective of whether it was an ultimate decision-maker).**

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[1] Treasury, Q&A: Loans to Air Carriers and Eligible Businesses and National Security Businesses (Updated as of April 10, 2020), available at https://home.treasury.gov/system/files/136/CARES-Airline-Loan-Support-Q-and-A-national-security.pdf.

As described above, in accordance with Treasury's public guidance regarding loans to national security businesses, the Secretary of Defense delivered to Treasury a recommendation and certification that YRC is critical to maintaining national security, and the Secretary of the Treasury determined that YRC is critical to maintaining national security based upon the Secretary of Defense's recommendation and certification.

We understand that the Commission sent a separate letter on this topic to Secretary Esper on August 7, 2020, and respectfully defer to the Department of Defense to the extent the Commission is interested in further information on the Department of Defense's decision-making process.

3. **Did the Treasury communicate with any creditors of YRC, including lenders or health, welfare, and pension funds, with respect to YRC's designation as a business critical to maintaining national security, the Treasury's loan transaction with YRC, or otherwise? If so, please provide a list of such creditors and a summary of such communications.**

   We are not aware of any Treasury communications with YRC's creditors with respect to Treasury's determination that YRC is a business critical to maintaining national security. As described above, Treasury's determination was based upon the recommendation and certification by the Secretary of Defense that YRC is critical to maintaining national security.

   As Treasury evaluated whether to make a loan to YRC and potential terms for such a loan, Treasury held discussions with some of YRC's existing lenders. These discussions enabled Treasury to assess the appropriate size and structure of Treasury's loan and were necessary to secure the existing lenders' agreement to amend their outstanding loans to YRC to permit the Treasury loan. For these purposes, Treasury communicated with Apollo Global Management, Beal Bank, Citizens Bank, Bank of America Merrill Lynch, and Deutsche Bank.

   In addition to Treasury's communications with YRC's creditors, as part of Treasury's evaluation of YRC's finances and potential credit risks, Treasury held discussions with the company's employee labor union regarding YRC's obligations to its employees. Treasury also held discussions with the company's largest health insurance provider regarding the company's liabilities and the scheduled cancellation of the health insurance coverage of company employees.

4. **While YRC's business, like many other American businesses, may have been impacted by the COVID-19 crisis, YRC's financial troubles also predate the COVID-19 crisis. YRC's credit has been rated non-investment grade for over a decade and the pandemic may only have been the straw that broke the camel's back. Given those preexisting problems, how does the Treasury reconcile YRC's loan with the statutory language in Subtitle A stating that the Treasury is authorized to make loans "to provide liquidity to eligible businesses . . . related to losses incurred as a result of coronavirus"?**

YRC faced significant losses as a result of the spread of COVID-19. As the pandemic hit the U.S. economy, YRC's shipments fell almost 30% from March 13, 2020 to April 10, 2020. As a result, YRC's revenue was projected to fall 16% in 2020 compared to 2019. The fall in revenue created a liquidity crisis at the company.

5. **Please provide all documentation, analysis, and recommendations concerning the Treasury's loan to YRC that Perella Weinberg Partners and any other external financial advisors produced for Treasury.**

Materials produced by Treasury's external financial advisors are attached.

We are coordinating with Commission staff on the production of additional responsive documents that contain sensitive, nonpublic information and should be handled in a confidential manner.

6. **How did the Treasury determine that $700 million was an appropriate amount for YRC's loan? Please provide all documentation and analysis supporting the Treasury's conclusion, including any analysis produced by Perella Weinberg Partners and any other external financial advisors for the Treasury.**

YRC's fall in revenue as a result of the spread of COVID-19 created a liquidity crisis that forced the company to delay payments for employee health insurance and pension contributions and depleted the company's working capital. Based on discussions with the company, Treasury determined that $300 million—the amount of Treasury's Tranche A Loan—was an appropriate amount to enable the company to meet near-term obligations and working capital needs. In addition, YRC's fall in revenue had disrupted a plan to upgrade YRC's fleet of tractors and trailers to improve efficiency. Projections supported a capital expenditure level of $400 million—the amount of Treasury's Tranche B Loan—over the next two years for this purpose.

Drawings under Treasury's $400 million Tranche B Loan can only be used for the acquisition of tractors and trailers and are subject to a CapEx Plan that must be approved by the Treasury every quarter based on the company's most recent financial and operating results and updated projections of performance.

7. **The Commission notes that a portion of the loan will be used by YRC to finance capital expenditures, such as the purchase of tractors and trailers. How are these capital expenditures related to YRC's "losses incurred as a result of coronavirus"?**

YRC's substantial fall in revenue as a result of the COVID-19 pandemic created a liquidity crisis that prevented the company from carrying out necessary capital expenditures, and the liquidity provided by Treasury to enable those expenditures is therefore "related to losses incurred as a result of coronavirus." Treasury's Tranche B Loan will finance capital expenditures to support the viability of the company. Treasury holds a first-priority lien over all assets purchased with the proceeds of the Tranche B Loan.

8. **The Commission notes that a portion of the loan will be used by YRC to pay deferred pension and healthcare liabilities. How are these deferred liabilities related to YRC's "losses incurred as a result of coronavirus"?**

   Similar to the issues described above relating to the use of Treasury's loan proceeds for capital expenditures, YRC's substantial fall in revenue as a result of the COVID-19 pandemic prevented the company from paying its healthcare and pension obligations. Thus, the liquidity provided by Treasury to cover those expenses is "related to losses incurred as a result of the coronavirus."

9. **The Letter states that "the interest rate of LIBOR plus 3.5% on the YRC loans was set to be above the interest rate of LIBOR plus 3% applicable to loans made by banks participating in the Federal Reserve's Main Street Lending Program (MSLP)." The Letter also notes that the Federal Reserve set the interest rate for the MSLP at a "penalty rate." However, neither LIBOR plus 3% nor LIBOR plus 3.5% is a penalty rate for YRC. YRC received a $600 million loan just a few months prior to the coronavirus outbreak with an interest rate of LIBOR plus 7.5% (*i.e.*, 4% higher than the Treasury's loan to YRC). In light of that loan, why does the Treasury believe that an interest rate of LIBOR plus 3.5%, even including its assumptions about the valuation of its equity stake in YRC, was an appropriate interest rate for this loan? Please provide all documentation relating to the Treasury's interest rate and risk analysis, including any analysis produced by Perella Weinberg Partners and any other external financial advisors for the Treasury.**

   Section 4003(c)(1)(A) of the CARES Act provides that loans to national security businesses will be at a rate determined by the Treasury Secretary based on the risk and current average yield on outstanding marketable obligations of the United States of comparable maturity. Treasury considered the interest rate applicable to bank loans under the Federal Reserve's Main Street Lending Program. The interest rate under the Main Street Lending Program was set at a "penalty rate" of Libor plus 3%, and Treasury set the interest rate on the YRC loan at 0.5% above that rate. The duration and credit risk of the Treasury loan to YRC are comparable to the duration and credit risk of the Main Street loans. Another benchmark was YRC's $450 million revolving credit facility maturing in January 2024 (the same year as the Treasury loan), which bears an interest rate of Libor + 2.25%.

   Importantly, Treasury's compensation for this loan is not based only on the interest rate: Treasury also received compensation in the form of a 29.6% equity holding in YRC, which has a current market value of $67 million. An analysis prepared by Treasury's financial advisor, using a range of estimates and projections, produced an estimated total return to taxpayers in excess of 12% per annum based on an assumption of a four-year holding period of the equity stake.

10. **The Letter analogizes the terms of the YRC loan with the terms of loans made by the Federal Reserve under the MSLP. The Treasury states "[t]he MSLP was established to provide bridge financing to companies of *speculative-grade credit risk* whose revenues were negatively affected by the economic impact of the COVID-19 crisis." However,**

this appears to be at odds with the Treasury's prior statement that "[t]he Main Street program was established to provide a safety net for small and medium-sized businesses that were in *sound financial condition* before the pandemic." Please clarify.

The majority of borrowers under the Main Street Lending Program were in sound financial condition but below investment-grade credit risk before the pandemic. The impact of COVID-19 on the operations and revenues of these companies has lowered their creditworthiness further. Like these companies, YRC's financial condition was harmed by the effects of COVID-19.

11. **In determining that its loan to YRC was "sufficiently secured" as required by the CARES Act, the Treasury assumes a 20% discount for the liquidation value of the equipment YRC will purchase with the proceeds of the loan. Please provide the basis for determining that 20% is an appropriate discount rate for such equipment, including all related documentation such as any analysis produced by Perella Weinberg Partners and any other external financial advisors for the Treasury.**

    Based on discussions with the borrower, Treasury's financial advisors, and Treasury's risk analysis experts, 20% was determined to be a reasonable discount for such collateral, based on market prices for used tractors and trailers.

12. **The Treasury states that it determined that YRC has excess existing collateral of $545.7 million to secure the $700 million loan, along with an interest in certain equipment purchased with proceeds of the loan. The Commission notes that the Treasury's loan is secured by a combination of a first-priority security interest in certain escrow accounts, a third-priority security interest in YRC's personal property, a third-priority mortgage or deed on certain real property, a third-priority pledge of YRC's equity interests, and a first-priority security interest on certain equipment YRC purchases with proceeds of the loan. Did the Treasury consider seeking additional first-priority interests on YRC assets? If not, why not? Please provide all documentation supporting the Treasury's conclusion that YRC's loan is "sufficiently secured," including any analysis produced by Perella Weinberg Partners and any other external financial advisors for the Treasury, diligence reports, and other professional opinions such as appraisals.**

    Treasury estimated that it would have collateral of $866 million securing its $700 million loan (a collateralization level of 124%) if YRC draws the full amount of both tranches of the loan.

    First, Treasury has a first-priority interest in all equipment purchased with the proceeds of its Tranche B Loan. If the full $400 million is disbursed under the Tranche B Loan, there will be newly purchased tractors and trailers with a purchase cost of $400 million securing the Tranche B Loan on a first-lien basis. Based on a 20% discount for the liquidation value of this collateral, the first-priority lien would provide Treasury with $320 million in security.

Second, the company's other lenders already hold a first-priority interest in the company's existing assets. But Treasury's loan is secured by the value of the company's existing assets in excess of those existing loans. The excess existing collateral totals $546 million.

13. **The Treasury's 29.6% equity stake in YRC is reportedly to provide "appropriate taxpayer compensation" for the loan. How did the Treasury determine that a 29.6% equity stake was appropriate? How and when does the Treasury anticipate realizing returns on its equity in YRC? Please provide all documentation and analysis supporting the Treasury's conclusion, including any analysis produced by Perella Weinberg Partners and any other external financial advisors for the Treasury.**

Treasury received two layers of taxpayer compensation from the YRC loan. First, the company is paying an interest rate of Libor + 3.5%. Second, the 29.6% equity stake currently has a market value of $67 million. As required by section 4003(d) of the CARES Act, this enables taxpayers to participate in the appreciation in the company's equity value. Treasury will realize its return on the YRC equity stake based on market conditions, with the objective of obtaining a good return for the taxpayer.

An analysis prepared by Treasury's financial advisor, using a range of estimates and projections, produced an estimated total return to taxpayers in excess of 12% per annum based on an assumption of a four-year holding period of the equity stake. Treasury, with the advice of its financial advisor, considered that these estimated returns provided appropriate compensation for the taxpayer.

14. **Please also provide the Commission with a copy of the loan application submitted by YRC, which, per the Treasury's form application, includes information regarding YRC's U.S. operations, covered losses, financial plan, etc.**

A copy of YRC's loan application is attached.

We are coordinating with Commission staff on the production of additional responsive documents that contain sensitive, nonpublic information and should be handled in a confidential manner.

15. **How will the Treasury monitor whether YRC complies with Section 12.03 of the loan credit agreement's terms on maintenance of employment levels?**

The loan agreement between Treasury and YRC imposes extensive reporting and oversight requirements on the company to enable Treasury to monitor YRC's compliance with the agreement. Among other relevant provisions, section 6.02(a) of the agreement requires YRC to produce to Treasury a duly completed compliance certificate every quarter; section 6.02(e) of the agreement requires YRC to produce to Treasury such information regarding YRC's business, legal, financial, or corporate affairs as Treasury may from time to time reasonably request; section 6.10 provides Treasury with authority to examine YRC's corporate, financial and operating records and to discuss the company's affairs with its directors and officers;

section 6.19 requires the company to provide Treasury, the Treasury Inspector General, and other entities unrestricted access to all of YRC's records related to the Loans, including access to the company's personnel for interviews; section 12.01 requires the company to provide any information requested by Treasury to assess YRC's compliance with the applicable requirements under Title IV of the CARES Act.

16. **The Treasury has previously told the Commission that "[t]ogether with the other data and information provided in [loan] applications, Treasury will develop standards for adequate and appropriate taxpayer protections. Treasury has not yet determined the final form of taxpayer protection that will be required, but anticipates applying a uniform standard that satisfies the requirements of [the CARES Act]." Please provide the uniform standard that the Treasury is using to measure adequate and appropriate taxpayer protections, including the standards applied to the YRC loan.**

    Treasury continues to anticipate applying a uniform approach to taxpayer protection for most borrowers. For public companies, in accordance with section 4003(d) of the CARES Act, the required taxpayer protection will generally consist of warrants, the amount of which will be based on the principal amount of the loan. For nonpublic companies, the required taxpayer protection will generally consist of payment-in-kind interest on the loan.

17. **The Letter states that the Treasury adopted a credit test for national security loans consisting of three criteria and that an applicant passes this test if it meets any two of those criteria. Will the Treasury deny loans to companies that are designated as being critical to maintaining national security but do not pass this credit test?**

    Treasury does not expect to make a loan to any company that does not meet Treasury's applicable credit standards.

18. **The Treasury previously told the Commission that, as of June 17, 2020, the Treasury "received 70 applications for the national security loan program, 25 of which meet one of the two national security eligibility criteria established by Treasury, although one of those has been withdrawn." Please provide an update regarding the total number of loan applications for the national security loan program the Treasury has received to date and the status of those loan applications, including whether the Treasury currently anticipates issuing additional loans or loan guarantees under this program.**

    As of August 25, 2020, Treasury had received 74 applications for the national security loan program. Of these 74 applications, one loan has been made (YRC), 17 are currently being processed, and the remaining 56 have been or are expected to be withdrawn or rejected.

P / W / P
PERELLA WEINBERG PARTNERS

Davis Polk

Project Brick Road: SUMMARY OF TERMS
July 7, 2020

	TERMS
UST Investment	■ **Tranche A: Near-Term Contractual Obligations** – **Amount:** $300 million ($200 million funded at close) – **Security:** 3rd lien on all assets of the Company – **Coupon:** L + 3.50% total: consisting of 1.50% cash and 2.00% PIK – **Maturity**: September 30, 2024 ■ **Tranche B: Capital Expenditures / Fleet Investment** – **Amount:** $400 million (distributions subject to CapEx Plan) ■ Investments to be made pursuant to capital expenditure plan to be approved by UST and subject to periodic review by UST – **Security:** 1st lien on newly purchased fleet collateral; 3rd lien on all other assets of the Company – **Coupon:** L + 3.50% cash – **Maturity**: September 30, 2024 ■ **UST to receive 42% share issuance (equal to 29.6% pro forma fully diluted ownership)** – UST shares to be held in voting trust
Treatment of Existing Term Loan	■ Reversion of Existing Term Loan coupon to contractual rate of L + 7.50% cash ■ Capitalization of interest accrued since 12/31/19 through 6/30/20 ■ Modification of EBITDA covenant and extension of covenant holiday through Q3'21 ■ Minimum liquidity covenant of $125 million ■ 1/3 participation in collateral pool consisting of rolling stock acquired off lease
Treatment of Existing ABL	■ Extension of contractual maturity to January 2, 2024 ■ Increase in coupon of 50 bps
Other	■ Remedy of past-due health care obligations and any other existing obligations and defaults

SECRETARY OF DEFENSE
1000 DEFENSE PENTAGON
WASHINGTON, DC 20301-1000

JUN 2 6 2020

The Honorable Steven Mnuchin
Secretary of the Treasury
U.S. Department of the Treasury
Washington, DC 20220

Dear Mr. Secretary:

The Department of Defense has been collaborating with the Treasury Department in executing loans under section 4003(b) of the Coronavirus Aid, Relief, and Economic Security (CARES) Act, Public Law 116-136 . Certain criteria were set forth in the Treasury's loan application that would allow companies to qualify for these loans. One of these requires the Department of Defense to provide recommendation and certification that the applicant business is critical to maintaining national security. We have determined that the following four companies meet this requirement, and accordingly I provide my certification that the following four companies are critical to maintaining national security. These companies are:

- [redacted]
- [redacted]
- [redacted]
- Yellow Roadway Corporation Worldwide

Please let me know if you require any additional information from the Department of Defense to process the applications from these companies. We look forward to continuing our partnership on these activities as we help our defense industrial base recover from impacts due to coronavirus disease 2019.

Sincerely,

Mark T. Esper

Appendix C:
Letter from Department of Defense to Senator Pat Toomey, dated September 2, 2020

OFFICE OF THE UNDER SECRETARY OF DEFENSE
3000 DEFENSE PENTAGON
WASHINGTON, DC 20301-3000

ACQUISITION
AND SUSTAINMENT

SEP 0 2 2020

The Honorable Pat Toomey
Congressional Oversight Commission
United States Senate
Washington, DC 20510

Dear Senator Toomey:

We appreciate the Congressional Oversight Commission's letter dated August 7, 2020, requesting information related to the Defense Department's recommendation and certification that YRC is critical to maintaining national security. We expect to respond to your letter by September 18, 2020. Thank you for your patience.

Sincerely,

Jeffrey Nadaner

Jeffrey (Jeb) Nadaner, Ph.D.
Deputy Assistant Secretary of Defense
for Industrial Policy

Appendix D:
Municipal Liquidity Facility Hearing Follow-up Questions to Treasury Department, dated September 29, 2020

REP. FRENCH HILL
BHARAT RAMAMURTI
REP. DONNA E. SHALALA
SEN. PAT TOOMEY

SDG–55 DIRKSEN SENATE
OFFICE BUILDING

WASHINGTON, DC 20510
(202) 224–5050

Congressional Oversight Commission

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

September 29, 2020

Dear Secretary Mnuchin:

As you are aware, on September 17, 2020, the Oversight Commission conducted a hearing regarding the implementation of the Municipal Liquidity Facility, at which a representative of the Federal Reserve and certain other witnesses appeared and testified. The Oversight Commission had also requested that the Treasury Department provide a representative to testify at the hearing, but the Treasury Department declined to do so.

Section 4020(b) of the CARES Act charges the Oversight Commission with the duty to conduct oversight of both the Treasury Department and the Federal Reserve with respect to Subtitle A, Division A programs. Pursuant to Section 4020(e)(1), (4) of the Act, the Oversight Commission requests your response to the attached questions regarding the Municipal Liquidity Facility. In light of the Oversight Commission's monthly reporting obligations, we ask that you provide the information requested in this letter by October 16, 2020.

Thank you for your attention to this matter.

Sincerely,

/s/
French Hill
Member of Congress

/s/
Bharat Ramamurti
Commissioner

/s/
Donna E. Shalala
Member of Congress

/s/
Pat Toomey
U.S. Senator

CONGRESSIONAL OVERSIGHT COMMISSION

Questions for the U.S. Treasury Regarding the Municipal Liquidity Facility Established by the Federal Reserve Pursuant to the CARES Act.

Questions for the Record Submitted to U.S. Treasury from the Congressional Oversight Commission

Question 1: What is the Treasury Department's role in establishing, designing, modifying, and operating the Municipal Liquidity Facility?

Question 2: Who is the point person at the Treasury Department responsible for matters involving the Municipal Liquidity Facility?

Questions for the Record Submitted to U.S. Treasury from Commissioner Bharat Ramamurti & Congresswoman Donna E. Shalala

Question 1: In particular, what role has the Treasury Department played with respect to determining each of the following? Please separately describe any involvement of the Treasury Department in proposing, revising, approving, rejecting, or otherwise weighing in on the following:

a. The amount of the equity investment

b. The original rates

c. The revised rates

d. The term length

e. The types of notes eligible

f. The limitations on uses of loan proceeds

g. The facility's expiration date

h. The original population thresholds

i. The revised population thresholds

j. The gubernatorial designation process

k. The number of Revenue Bond Designations permitted each jurisdiction

l. The credit rating thresholds

m. The requirement that borrowers be rated by a National Statistical Ratings Organization

n. The eligibility of issuer types other than U.S. states, cities, and counties

o. The eligibility of Guam

p. The eligibility of Puerto Rico

q. The eligibility of other U.S. territories and possessions

r. The eligibility of Indian Tribes

s. Any other aspect of the rates, terms, or conditions

Question 2: Has the Treasury Department rejected or declined to approve any proposals (whether formally denominated as proposals or not) from the Federal Reserve with respect to the items listed above (Question 2(a)-(s)) or that otherwise pertain to the Municipal Liquidity Facility? If so, please separately describe each such proposal and the Treasury Department's reasons for not approving it.

Question 3: As a legal matter, does the Treasury Department believe the current Municipal Liquidity Facility rates could be decreased, while still complying with the CARES Act, Section 13(3) of the Federal Reserve Act, and accompanying regulations?

Question 4: As a policy matter, does the Treasury Department believe the rates should be decreased?

Question 5: As a legal matter, does the Treasury Department believe the term length for Municipal Liquidity Facility loans could be increased beyond three years, while still complying with the CARES Act, Section 13(3) of the Federal Reserve Act, and accompanying regulations?

Question 6: As a policy matter, does the Treasury Department believe the term length should be increased?

Question 7: Does the Treasury Department believe that cuts to state and local governments' spending would be a drag on the economic recovery?

Question 8: Does the Treasury Department believe the Municipal Liquidity Facility is a substitute for direct aid to state and local governments?

Question 9: Does the Treasury Department believe promoting employment is an objective of the Municipal Liquidity Facility?

Question 10: Does the Treasury Department believe that the Municipal Liquidity Facility, as currently structured, accomplishes Subtitle A's purpose "to provide liquidity to [States and municipalities] related to losses incurred as a result of coronavirus"?

Question 11: Does the Treasury Department believe that the Municipal Liquidity Facility should be extended beyond its current expiration date of December 31, 2020?

Question 12: Given the minimal participation in the Municipal Liquidity Facility to date, does the Treasury Department believe that the population and designation restrictions for "Eligible Issuers" remain necessary? If so, why?

CONGRESSIONAL OVERSIGHT COMMISSION

Questions for the U.S. Treasury Regarding the Municipal Liquidity Facility Established by the Federal Reserve Pursuant to the CARES Act.

Questions for the Record Submitted to U.S. Treasury from Commissioner Bharat Ramamurti

Question 1: As a legal matter, does the Treasury Department believe the term length for Municipal Liquidity Facility loans could be increased to ten years, while still complying with the CARES Act, Section 13(3) of the Federal Reserve Act, and accompanying regulations?

Question 2: Does the Treasury Department believe the Municipal Liquidity Facility has legal authority to sustain losses?

Question 3: Does the Treasury Department believe it would be acceptable for the Municipal Liquidity Facility to sustain losses?

Question 4: What amount of losses, if any, is the Treasury Department willing to sustain?

Question for the Record Submitted to U.S. Treasury from Senator Pat Toomey

Question 1: Given the municipal bond market's significant recovery since March, does the Treasury Department believe it is still necessary for the Federal Government to intervene in the municipal bond market?

Appendix E:
Letter from Alameda County Office of the Treasurer and Tax Collector to Congressional Oversight Commission, dated September 16, 2020

Alameda County
Office of the Treasurer
and Tax Collector

Henry C. Levy, Treasurer-Tax Collector

Julie P. Manaois, Chief Deputy Tax Collector

BY E-MAIL TO Hannah Garden-Monheit (**Hannah_Garden-Monheit@coc.senate.gov**)

September 16, 2020

Congressional Oversight Commission
SDG55 Dirksen Senate Office Building
Washington, DC 20510

Honorable Commission Members:

I am the elected Treasurer-Tax Collector of Alameda County in the Bay Area of California. We are a county of over a million and a half people, with an annual budget of approximately $3.4 billion. The county government alone employs almost 10,000 people; many tens of thousands more have jobs in our 14 different cities, 20 special districts, and 18 school districts. Over a half billion of our budget is our own property tax revenue, $75 million is our own sales tax, but the cities, special districts and schools are more dependent on the state revenues, which rely heavily on sales and income taxes.

As everyone is aware, the economic crisis triggered by the novel coronavirus has caused a tremendous downturn in those sales and income tax revenue provided by the state. This will have a devastating impact on our government and the services we provide. But what many may not be aware of is that the tax revenue we do receive will be delayed substantially. The State of California has allowed merchants to delay the payments of their sales taxes and has suspended the imposition of property tax penalties through May, 2021 for all those affected by COVID. These measures are important ways to preserve the businesses and homes of affected individuals, but they have the effect of delaying the collection of our tax revenue. Furthermore, though property taxes tend not to be as pro-cyclical as sales and income taxes, we expect the property tax collection rate to drop precipitously this coming December, the next semi-annual deadline. These effects will impact not only our budget, but the budgets of the cities within Alameda County: Oakland, Berkeley, Fremont, Hayward and others.

Some of this revenue will be received eventually, but in the meantime, we have to adjust to a very different collection regime. A source of low-cost credit would be very helpful to weathering the storm that is -- let me emphasize -- still gathering. In March and April as the virus lockdown was upon us, we discussed ways to meet the coming challenge and were pleased to hear the Fed had opened up a lending facility and that we might be able to access it to help not only our own budget, but the budget of our cities. Unfortunately, the terms of the credit make it challenging to use. The penalty rate charged is an obvious disincentive, and the terms are just barely as long as we think the crisis will last. A crisis of two to three years does not end suddenly. Lending terms of five to seven, even ten years would be more appropriate to help us through the downturn we expect.

Earlier this year, I convened a number of meetings with finance directors of the cities in the county. Of those surveyed, given the cost of the credit and the term lengths, most thought it would be more flexible and less expensive to use private markets. As a result, we abandoned our plan to address this crisis with a joint powers facility to serve the county, hoping that private markets will be able to help our governments individually when needed. However, this is not something that we desired, and I hope that this attitude can be reversed. But, that depends on the terms of the MLF being changed.
There is opportunity here for the Fed to use the funds Congress appropriated to encourage states and counties to act in a macroeconomically constructive way, to batten down and weather the storm instead of jettisoning cargo and abandoning ship. But this would be a different MLF, constructed with the needs of the state and local governments in mind rather than the needs of bond market participants.

Yours truly,

/s/ Henry C. Levy

Henry C. Levy
Treasurer-Tax Collector
Alameda County

The following elected officials of Alameda County want to lend our support for Congress to amend the CARES Act to mandate that the Federal Reserve improve the terms of loans and grants to local and state governments. The Municipal Liquidity Facility has the potential to save jobs and businesses, and the funds would be going to governments who are used to providing well-placed benefits to eligible recipients. Without such funds, the loss of sales, income, and even property tax loss revenue will result in layoffs, foreclosures, and further reduce revenues.

Nate Miley
Alameda County Supervisor

Jesse Arreguin
City of Berkeley Mayor

Alexandra Medina
City of Emeryville City Council

Appendix F:
Letter from National Association of Counties
to Congressional Oversight Commission, dated September 24, 2020

September 24, 2020

The Honorable French Hill
1533 Longworth House Office Building
Washington, D.C. 20515

The Honorable Donna Shalala
1320 Longworth House Office Building
Washington, D.C. 20515

The Honorable Pat Toomey
248 Russell Senate Office Building
Washington, D.C. 20510

Commissioner Bharat Ramamurti
SD-G55 Dirksen Senate Office Building
Washington, D.C. 20510

Dear members of the Congressional Oversight Commission:

On behalf of the National Association of Counties (NACo) and the 3,069 counties we represent, thank you for holding last week's hearing to examine the Municipal Liquidity Facility (MLF) established under the Coronavirus Aid, Relief, and Economic Security (CARES) Act. As members of NACo's Fiscal Policy and Pensions Subcommittee, we understand the importance of this critical program, which works to support county governments impacted by the COVID-19 pandemic.

While we appreciate federal efforts made thus far, counties and our residents continue to experience devastating health and economic impacts as we remain on the frontlines of the ongoing coronavirus pandemic. America's counties agree on the following principles:

- Counties of all sizes need access to additional direct, flexible funding to fight this pandemic, rebuild the economy and strengthen our communities

- The U.S. Department of Treasury and Federal Reserve should expand access to the Municipal Liquidity Facility to help address local government budget challenges and support the national economy

<u>Counties of all sizes need access to additional direct, flexible funding to fight this pandemic, rebuild the economy and strengthen our communities</u>

While the CARES Act was an important first step, the aid provided is not enough to support our efforts to effectively implement containment and community mitigation strategies that will preserve the health and safety of our residents and local communities.

Counties across the country are in desperate need of additional assistance to protect the lives of citizens and re-open the economy. The CARES Act did not contain funding to offset the drastic state and local revenue shortfalls that county governments are experiencing across the country, nor did it provide any relief to local governments with populations under 500,000. In fact, only five percent of the nation's counties were eligible to receive direct payments from the U.S. Department of Treasury.

The detrimental fiscal impact of COVID-19 extends far beyond urban counties. Counties with populations below 500,000 are also taking a major hit to our budgets. New NACo research estimates that the COVID-19 pandemic could have a $202 billion budgetary impact on counties of all sizes through fiscal year 2021, including $172 billion in lost revenue and an additional $30 billion in COVID-19 response costs.

In total, counties are estimated to lose $35 billion in sales tax revenue through fiscal year 2021. Across the nation, 69 percent of counties that levy local option sales tax have reported a decline in sales tax revenue as a result of COVID-19, with losses ranging from 7 to 41 percent. Furthermore, counties are also facing cash flow challenges due to the delayed collection and timing of property taxes. State and county authorities in 16 states across the nation have extended property tax deadlines or penalty relief for late payment.

This tremendous loss of revenue and increase in costs may ultimately result in cuts to essential county services including public safety, social services, child protective services, mental health, homelessness, jail diversion, reentry and more.

To maintain mandated balanced budgets, many counties have already been forced to cut costs by furloughing or laying off workers. Since the start of the pandemic, there have been more than 800,000 jobs lost in the local government sector – 332,000 of which were non-education jobs ranging from law enforcement officers to health care practitioners, social workers, maintenance crews, construction works, administrative support and more. **In total, local governments have lost 1.2 million jobs since the outset of the pandemic.**

Beyond the impacts on our workforce, the financial fallout from COVID-19 has forced cuts and delays in capital investments. NACo's research finds that 66 percent of counties have cut, or delayed infrastructure maintenance and 54 percent have cut or delayed new infrastructure projects. These cuts will mitigate cash flow shortages in the short-term but will have long-term economic impacts and disrupt critical local development.

If counties are to continue to play a significant role in mitigating the spread of the COVID-19 virus, we need a robust coronavirus relief bill that ensures counties of all sizes have access to additional direct, flexible funding to fight this pandemic, rebuild the economy and strengthen our communities.

<u>The U.S. Department of Treasury and Federal Reserve should expand access to the Municipal Liquidity Facility to help address local government budget challenges and support the national economy</u>

The MLF is an important piece of the initial and necessary response to the COVID-19 pandemic. Although the MLF provided some stability to the municipal bond market when it was established, it is not practical or accessible to entities that need it most – state and local governments.

To ensure that state and local governments may take advantage of this tool, we recommend that the U.S. Treasury and Federal Reserve take the following steps to make the MLF more accessible:

- **The Federal Reserve should extend the MLF's underwriting deadline beyond December 31, 2020.** Under the CARES Act, the facility is currently set to expire at the end of this year even though the state and local government budget crisis is just beginning. For example, according to NACo's research, while 27 percent of counties have already experienced reduced property tax collection in the current budget cycle, this number may almost double to 43 percent during next year's budget cycle.

- **The Federal Reserve should lower the MLF population threshold so that more counties are eligible to sell short-term debt to the facility.** While we appreciate that the Federal Reserve lowered the population threshold for counties from 2 million residents to 500,000, the new threshold still leaves out the majority of our nation's counties. In fact, under the new population threshold, only 5 percent of counties have access to the MLF. As mentioned earlier, counties of all sizes are facing dire fiscal impacts. Expanding the scope of the MLF would help relieve some of this pressure and is an important step to stabilize the municipal market in the future.

- **The Federal Reserve should restructure the facility's pricing structure and lower the current rates.** As of September 18, the facility had purchased only two issuers, which demonstrates that the MLF's current pricing is unfavorable for many municipal issuers. For example, in Fresno County, Calif., the MLF offers a 1.20 percent rate for AA governments wishing to borrow, in comparison to the county's short-term TRAN of 0.18 percent. Therefore, Fresno County has decided to not use the MLF since there are other less costly rates the county can borrow from. The Federal Reserve should make the rate as low as possible for local governments to save taxpayer dollars and jobs as well as prevent future drastic budget cuts.

Thank you for your continued hard work and leadership during these challenging times. We would welcome the opportunity to discuss this issue further. We are committed to a solution that helps our nation mitigate, respond, and recover from this historic crisis.

Sincerely,

Members of NACo's Fiscal Policy and Pensions Subcommittee:

Hon. Kevin L. Boyce
Commissioner
Franklin County, Ohio

Hon. Laura Montoya
Treasurer
Sandoval County, New Mexico

Hon. Kurt A. Gibbs
Board Chair
Marathon County, Wisconsin

Hon. Cindy Bulloch
County Assessor
Iron County, Utah

Hon. John Wilson
County Assessor
King County, Washington

Hon. Dolores Ortega-Carter
Treasurer
Travis County, Texas

Hon. Nathan Magsig
Supervisor
Fresno County, California

Hon. Brian Sullivan
Treasurer
Snohomish County, Washington

Diane Dillon

Hon. Diane Dillon
Supervisor
Napa County, California

Appendix G:
Federal Reserve and Bank Policy Institute Responses to Main Street Lending Program Hearing Follow-up Questions, dated August 31, 2020

FEDERAL RESERVE
BANK OF BOSTON ™

600 ATLANTIC AVENUE • BOSTON MA 02210
WWW.BOSTONFED.ORG

ERIC S. ROSENGREN
PRESIDENT AND
CHIEF EXECUTIVE OFFICER

PHONE: 617.973.3090
FAX: 617.973.3173

August 31, 2020

Mr. Bharat Ramamurti, Commissioner
Congressional Oversight Commission
Washington, D.C. 20510

Dear Commissioner Ramamurti:

Enclosed are my responses to the questions you submitted following the August 7, 2020,[1] hearing before the Congressional Oversight Commission.

Please let me know if I may be of further assistance.

Sincerely,

Eric Rosengren

Enclosure

[1] Questions related to this hearing were received on August 14, 2020.

CONGRESSIONAL OVERSIGHT COMMISSION
August 7, 2020 Hearing: *Examination of the Main Street Lending Program Established by the Federal Reserve Pursuant to the CARES Act.*

Follow-Up Questions Submitted to President Eric Rosengren, Federal Reserve Bank of Boston (Witness Name) from Commissioner Ramamurti

<u>Question 1</u>: Many smaller cities, towns, school districts, and other public entities like hospitals function much like non-profits—both in terms of the essential role they play in our communities and with respect to how they obtain credit, with bank lending to local governmental entities constituting a large share of all outstanding municipal credit.[2] The Municipal Lending Facility (MLF) is ill-suited to serving these smaller governmental entities, who cannot participate directly in the MLF. Moreover, they may have trouble participating indirectly in the MLF through larger borrowers like state governments. Has the Federal Reserve considered whether there are unmet credit needs of such smaller governmental borrowers that could be met by expanding the MSLF to encompass them? Please explain whether the Federal Reserve believes such an expansion warranted.

In general, the Federal Reserve believes that the Municipal Liquidity Facility (MLF) is the best tool to address the liquidity challenges in the municipal bond market through which these entities normally obtain credit, rather than the Main Street Lending Program (Main Street or Program), which is a loan participation program. The purpose of the MLF is to enhance the liquidity of the municipal securities market by increasing the availability of funding to eligible issuers through purchases of their short-term notes. By addressing the cash management needs of eligible issuers, the MLF was also intended to encourage private investors to reengage in the municipal securities market, including across longer maturities. The MLF also encourages eligible issuers to borrow on behalf of and lend to smaller local governments and other entities that are not otherwise eligible for direct participation in the MLF. As a result of the deployment of the MLF and other Federal Reserve monetary tools, the municipal market has substantially recovered from its unprecedented sell-off in March and the vast majority of municipal issuers currently have access to capital at historically low costs of funds.[3] We will continue to closely monitor conditions in the markets for municipal securities and will evaluate whether additional measures are needed to support the flow of credit and liquidity to state and local governments.

The Main Street facilities for nonprofit organizations also have a role to play in providing credit to certain public entities, including public hospitals and public colleges and universities, that operate in a manner similar to other types of nonprofit organizations recognized as tax-exempt pursuant to 501(c)(3) of the Internal Revenue Code. The Federal Reserve has published the requirements that such public entities must meet to qualify as eligible borrowers for purposes of the Main Street facilities for nonprofit organizations. The eligibility criteria for the nonprofit lending facilities were designed in light of underwriting standards often applied by lenders in making loans to nonprofit borrowers, including nonprofit hospitals, colleges, and universities that have a similar financial profile to their public counterparts. The Federal Reserve is currently working to create the infrastructure necessary to fully operationalize the Main Street facilities for nonprofit organizations.

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[2] Ivanov, Ivan and Tom Zimmerman, "The Privatization of Municipal Debt," Brookings Institution Hutchins Center Working Paper #45 (Sept. 2018), *available at* https://www.brookings.edu/wp-content/uploads/2018/08/WP45.pdf.
[3] https://libertystreeteconomics.newyorkfed.org/2020/06/municipal-debt-markets-and-the-covid-19-pandemic.html.

<u>Question 2</u>: In a recent study examining the Payment Protection Program (PPP) administered by the Small Business Administration, the Federal Reserve Bank of New York found "significant coverage gaps" in the PPP's ability to reach Black-owned businesses, despite the pandemic's outsized impact on communities of color.[4] Will the Federal Reserve conduct a similar study of whether and how the CARES Act programs that it administers have impacted racial and ethnic minorities?

The Federal Reserve has taken a number of actions to facilitate broad coverage by Main Street. Recognizing that the circumstances, structure, and needs of small and medium sized for-profit and nonprofit organizations vary considerably, the Federal Reserve sought feedback from a wide range of potential borrowers, lenders and the general public on the proposed terms of the facilities to help make the Program as efficient and effective as possible. Based on this feedback, the Federal Reserve has modified the terms of the Program to provide greater access to credit for small and medium-sized for-profit and nonprofit organizations that were in sound financial condition prior to the pandemic.

To provide potential lenders with information about Main Street and to address their questions in real time, to date the Federal Reserve has held (and posted recordings of) 14 webinars and conducted a number of other events (including three in collaboration with the Small Business Administration) explaining aspects of the Program and engaging in question and answer sessions. On June 24, the Federal Reserve hosted a webinar on Main Street targeted toward minority- and women-owned businesses, and on August 4, the Federal Reserve hosted a webinar targeted toward tribal businesses. The Federal Reserve is conducting additional outreach to raise awareness of the program among women- and minority-owned businesses and in low- and middle-income communities, including sharing program information and updates with more than 70 associations and networks working with minority-owned and women-owned businesses.

To encourage their involvement, the Federal Reserve has also conducted outreach to minority depository institutions (MDIs) and community development financial institutions (CDFIs) to provide opportunities to learn about the Program. On July 1, as part of the Federal Reserve's Partnership for Progress program, staff of the Federal Reserve Board and FRBB, together with the National Bankers Association, held a briefing on Main Street for MDIs. On August 4, Federal Reserve Board and FRBB staff attended a National Business Inclusion Consortium event to present the details of the Main Street Program. On August 12, staff participated in an event sponsored by the Department of Commerce's Minority Business Development Agency and provided a Main Street Program overview.

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[4] Claire Kramer Mills, "Double Jeopardy: COVID-19's Concentrated Health and Wealth Effects in Black Communities," Federal Reserve Bank of New York (Aug. 2020), *available at* https://www.newyorkfed.org/medialibrary/media/smallbusiness/DoubleJeopardy_COVID19andBlackOwnedBusinesses.

These efforts will contribute to broad coverage. The Federal Reserve will continue to assess the efficacy of the Program, including its effects on low-income or minority communities.

Question 3: Will the Federal Reserve collect and report any data on whether minority-owned businesses are participating in the MSLF program?

The Federal Reserve will collect and disclose information regarding Main Street during the operation of the facilities, including information regarding names of lenders and borrowers, amounts borrowed and interest rates charged, and overall costs, revenues, and other fees. The Federal Reserve does not plan to collect information on minority status of borrowing entities. We will continue to conduct outreach sessions to underserved communities to promote Program awareness. Further, we will continue to monitor broader credit conditions across different communities and geographies and weigh adjustments needed to reach eligible borrowers.

Question 4: President Rosengren testified that Federal Reserve's outreach plan for the MSLF included an intentional effort to reach minority and women-owned businesses, minority depository institutions, and tribal businesses. What further steps is the Federal Reserve taking to ensure that the MSLF program is made available on an inclusive basis? For example, in light of reports of lending discrimination by banks participating in the PPP,[5] what steps will the Federal Reserve take to ensure that banks participating in the MSLF offer MSLF-backed loans on a non-discriminatory basis?

As indicated in response to Question 2, the Program is designed to have wide coverage, and the Federal Reserve has conducted outreach targeted toward minority, women-owned, and tribal businesses, as well as MDIs and depository CDFIs.

All eligible lenders under Main Street are federally regulated financial institutions, subject to ongoing federal supervision. Such lenders are instructed to employ their existing underwriting processes in relation to Main Street loans, and to use loan documentation that is substantially similar, including with respect to required covenants, to the loan documentation that the eligible lender uses in its ordinary course lending to similarly situated borrowers, adjusted only as appropriate to reflect the requirements of the Program. By structuring the Program in this way, the Federal Reserve expects that Main Street loans would be subject to the same regulatory infrastructure and supervisory scrutiny (including by the Federal Reserve, where applicable) as other loans made by the eligible lenders. As such, any discriminatory behavior by lenders will be addressed as appropriate under the law.

Question 5: In response to questions about whether certain MSLF program terms and requirements were changed in response to requests from the oil and gas industry, President Rosengren testified that "[i]n the discussions [he] ha[s] been involved in, we do not discuss

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[5] *Anneliese Lederer, et al., "Lending Discrimination within the Paycheck Protection Program," National Community Reinvestment Coalition (July 2020), available at* https://www.ncrc.org/lending-discrimination-within-the-paycheck-protection-program/.

specific industries." However, the Energy Secretary has stated publicly that he and Treasury Secretary Mnuchin worked with the Federal Reserve to ensure that the energy industry could participate in the Federal Reserve's lending facilities.[6] Is President Rosengren aware of any discussions, deliberations, meetings, or communications in which specific industries or companies were discussed—irrespective of whether he was personally involved in those discussions? If so, please identify what officials or agencies may have been involved.

The Main Street facilities are intended to improve financial or credit conditions broadly, not to allocate credit to narrowly defined sectors, industries, or classes of borrowers. I am not aware of any conversations regarding how the terms and conditions of the Main Street facilities would apply to oil and gas companies beyond conversations discussing how Main Street would apply to broad sectors of the economy.

From time-to-time, the needs of specific industries or types of borrowers are raised in internal discussions and deliberations in relation to Main Street. In designing the Program, the Federal Reserve received more than 2,200 comments from businesses of all sizes, across industries, and representing many sectors of the economy. Federal Reserve staff has considered issues pertaining to particular companies or industries — including manufacturers, commercial real estate companies, and retailers — when such concerns are raised by members of Congress or other public commenters. However, any decisions that the Federal Reserve has made in designing the Program were intended to meet the needs of a wide range of businesses across the economy, not in response to any particular industry's concerns or to ensure any particular industry's participation.

<u>Question 5</u>: The Federal Reserve publicly disclosed public comments that it received, which reportedly were the basis for changes to the MSLF made on April 30, 2020.[7] However, some of the changes made on April 30, 2020 are not reflected in any of those publicly disclosed comments, such as the deletion of the required attestation that the loan was needed "due to the exigent circumstances presented by the … COVID-19 pandemic." As the public record currently stands, the only evidence of anyone requesting that change and certain other changes is that they were requested only by the oil and gas industry,[8] and that requests by

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[6] *E.g.*, Timothy Gardner, "Trump administration working to ease drilling industry cash crunch," Reuters (Apr. 17, 2020), *available at* https://www.reuters.com/article/us-health-coronavirus-usa-oil-credit/trump-administration-working-to-ease-drilling-industry-cash-crunch-idUSKBN21Z1JY; Saleha Mohsin & Ari Natter, "Energy Chief Says Fed Asked to Expand Lending for Oil Firms," Bloomberg.com (May 12, 2020), *available at* https://www.bloomberg.com/news/articles/2020-05-12/energy-chief-says-fed-was-asked-to-expand-lending-for-oil-firms.

[7] *See* Press Release, "Federal Reserve Board announces it is expanding the scope and eligibility for the Main Street Lending Program," Federal Reserve (Apr. 30, 2020), *available at* https://www.federalreserve.gov/newsevents/pressreleases/monetary20200430a.htm (citing public comments as basis for loan term sheet adjustments).

[8] *E.g.*, Letter to Secretary Mnuchin and Chairman Powell from Senator Ted Cruz (Apr. 24, 2020), *available at* https://www.cruz.senate.gov/files/documents/Letters/4.24.2020%20Oil%20Gas%20Fed%20Lending%20Facility%20Letter.pdf (stating that "condition…that a borrower must attest they require financing because of circumstances attributed to COVID-19…may prove to be too restrictive" "in the context of energy").

that industry were sometimes made outside the ordinary public comment process available to everyone else.[9] Will the Federal Reserve publicly disclose all documents, communications, and records of communications that relate to the energy industry's participation in the MSLF?

When issuing the April 30, 2020 term sheets, the Federal Reserve and Treasury made a number of changes to the attestations that would have been required under the initial April 8, 2020 term sheets in light of the public comment period and further internal discussion and analysis. In particular, a number of changes were driven by comments raising questions about the precise meaning of certain proposed attestations, how borrowers and lenders could determine and evidence their compliance with such requirements, and how such attestations would be enforced. In the course of this careful review and rationalization, it was determined that there was not sufficient reason to retain the initially proposed borrower attestation that a loan was needed "due to the exigent circumstances presented by the … COVID-19 pandemic." The following considerations informed this decision:

- Due to the widespread effects of the pandemic, the Federal Reserve and Treasury anticipated that nearly all borrowers that would desire to access Main Street would have been affected adversely by the pandemic. Further, the Federal Reserve and Treasury determined that it would be difficult for many businesses to evidence the pandemic's effect on their business outside of pointing to decreased demand, which may not conclusively demonstrate a connection to the pandemic.[10]

- Under the Board's Regulation A, each borrower must certify that it is unable to secure adequate credit accommodations from other banking institutions. It was determined that this required certification would serve much of the same purpose as the removed attestation, because each address whether the Program is being used as a back-stop.

- Under section 13(3) of the Federal Reserve Act and the Board's Regulation A, each borrower must certify that it is not "insolvent." As clarified in the Main Street Borrower Certifications and Covenants, a borrower is insolvent if it has been "generally failing to pay undisputed debts as they become due" during the 90 days preceding the date of borrowing to the extent it is behind on its debts for reasons other than disruptions to its business resulting from the pandemic. For those behind on their debts due to the pandemic, the borrower is considered insolvent if it was generally failing to pay its undisputed debts in the 90 days

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[9] *E.g.*, Timothy Gardner, "Trump administration working to ease drilling industry cash crunch," Reuters (Apr. 17, 2020), *available at* https://www.reuters.com/article/us-health-coronavirus-usa-oil-credit/trump-administration-working-to-ease-drilling-industry-cash-crunch-idUSKBN21Z1JY (reporting Energy Secretary's statement that he met with U.S. energy industry representatives to discuss the size of loans they would need in order to participate in the MSLF).

[10] Similar concerns were raised by other commenters, including on p. 63 of the document, *available at* https://www.federalreserve.gov/monetarypolicy/files/mslp-public-comments-202007015.pdf; and p. 41 of the document *available at* https://www.federalreserve.gov/monetarypolicy/files/mslp-public-comments-202007016.pdf. In addition, during outreach to a trade association representing companies of all sizes and across all sectors, concerns were raised that this particular attestation could trigger material adverse change clauses in borrower's existing debt covenants.

preceding the later of March 1, 2020, or the date on which changes in its business activity related to the COVID-19 pandemic commenced. It was determined that this required attestation would serve much of the same purpose as the removed attestation by focusing on the financial condition of the borrower outside of the effects of the pandemic.

- The Program requires that any outstanding loans that the eligible borrower had with the eligible lender as of December 31, 2019, must have had an internal risk rating equivalent to a "pass" in the Federal Financial Institutions Examination Council's supervisory rating system on that date. A borrower meeting this criteria, but desiring a Main Street loan, is likely to have been adversely affected by the pandemic. It was determined that this requirement would serve much of the same purpose as the removed attestation by focusing on the financial condition of the borrower prior to the pandemic.

The Federal Reserve has disclosed the comments it received during the comment period, including those submitted by or on behalf of the oil and gas industry.

Question 6: Title 12 U.S.C. § 343(3) and 12 C.F.R. § 201.4 require the Federal Reserve's emergency lending programs to be "broad-based." In the Federal Reserve's view, as a legal matter, do these provisions permit changes to a program designed to benefit a particular industry or particular companies, so long as the program as a whole has broad eligibility? Please explain the Federal Reserve's view of what the broad-based requirement does and does not encompass.

Consistent with section 13(3) of the Federal Reserve Act, all of the Federal Reserve's facilities have broad, neutrally defined eligibility requirements and pricing mechanisms and are designed to minimize credit allocation while also minimizing risk to the taxpayer.[11] As the Federal Reserve and Treasury stated in March 2009, "actions taken by the Federal Reserve should aim to improve financial or credit conditions broadly, not to allocate credit to narrowly-defined sectors or classes of borrowers."[12]

The Federal Reserve Board formally interpreted the statutory "broad-based" requirement at 12 CFR 201.4(d)(4), which clarifies that "a program or facility has broad-based eligibility only if [it] is designed to provide liquidity to an identifiable market or sector of the financial system," and that a program or facility is not considered broad-based if it is designed to aid one or more failing companies, or if fewer than five persons or entities would be eligible to participate.[13]

[11] 12 U.S.C. § 343(3).
[12] Joint Press Release, The Role of the Federal Reserve in Preserving Financial and Monetary Stability Joint Statement by the Department of the Treasury and the Federal Reserve (Mar. 23, 2009), *available at* https://www.federalreserve.gov/newsevents/pressreleases/monetary20090323b.htm.
[13] 12 CFR 201.4(d)(4)(ii)-(iii).

Question 7: For the Secondary Market Corporate Credit Facility (SMCCF), the Federal Reserve has stated that it will leverage the Treasury equity at a ratio as low as 3 to 1,[14] while the MSLF appears to have a larger equity cushion. Is the Federal Reserve more willing to absorb risks with respect to the SMCCF than with respect to the MSLF? If so, why?

The Secondary Market Corporate Credit Facility (SMCCF) uses credit ratings to identify which debt instruments it may purchase and how much Treasury equity will be allocated to protect against losses from those instruments. The historical default rates of companies rated below investment grade are higher than those of companies rated above investment grade, but the SMCCF adjusts for heightened credit risk by allocating more Treasury equity to support purchases of companies rated below investment grade. In particular, the SMCCF leverages the Treasury equity at 10 to 1 when acquiring corporate bonds of issuers that are investment grade but only at 7 to 1 when acquiring corporate bonds of issuers that were previously rated investment grade but are now rated one rating grade below investment grade. When the SMCCF purchases exchange-traded fund (ETF) shares, it leverages the Treasury equity at between 10 to 1 and 3 to 1, depending on the risk profile of the ETF.

For Main Street, which lends primarily to companies that were in sound financial condition prior to the onset of the COVID-19 pandemic, and to companies for which a credit rating is usually not readily available, the Federal Reserve has leveraged the $75 billion equity investment at a maximum of 8 to 1. We feel that this ratio is appropriate given the creditworthiness of the borrowers for whom Main Street was designed.

Question 8: Has the Federal Reserve analyzed whether more companies would be served by the MSLF if the loan term were extended an additional year or more? Please explain whether the Federal Reserve believes such an extension warranted.

The five-year maturity for Main Street loans facilitates the provision of credit over the medium-term to bridge near-term cash flow disruptions that result from the COVID-19 pandemic. A longer maturity may contribute to the ability of some borrowers to repay a loan. A longer maturity may also increase risk to lenders or the taxpayer. The five-year maturity balances these competing considerations.

We will continue to monitor lending conditions broadly and consider adjustments to Main Street terms and conditions, as appropriate, working with the Department of the Treasury which has made an equity investment in a Special Purpose Vehicle (Main Street SPV) in connection with the Program. The facility was established by the Federal Reserve under the authority of Section 13(3) of the Federal Reserve Act, with approval of the Treasury Secretary.

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[14] Terms Sheet, Secondary Market Corporate Credit Facility, Federal Reserve (July 28, 2020), *available at* https://www.federalreserve.gov/newsevents/pressreleases/files/monetary20200728a1.pdf.

Question 9: Has the Federal Reserve analyzed whether Community Development Financing Institutions (CDFI) are able to originate MSLF loans? Please explain whether the Federal Reserve believes any changes to the MSLF would be needed to facilitate participation by CDFIs that serve low-income and minority communities, and whether it believes such changes warranted?

CDFIs that are depository institutions are eligible lenders under Main Street. At this time, nonbank CDFIs are not considered eligible lenders for purposes of the Program. Some aspects of the Program may limit participation by eligible CDFIs, which often originate loans smaller than the minimum Main Street loan or that emphasize underwriting criteria that differ from those used by Main Street. The Federal Reserve will continue to analyze these issues. As emphasized in my testimony and responses to questions at the hearing, adjustments to the Program, including a lower minimum loan size, would provide benefits but also entail operational costs, and there may be more efficient approaches to supporting CDFIs and the communities they serve than adjustments to Main Street.

Question 10: Has the Federal Reserve analyzed whether lowering the minimum loan size further would facilitate participation by more businesses with unmet needs? Please explain whether the Federal Reserve believes such changes warranted. To the extent the Federal Reserve believes a lower loan size would present administrability issues given the capacity of the Boston branch to oversee this complex program, has it considered creating another facility administered by a branch other than Boston?

In order to manage the operational elements of the Program, we have maintained a minimum loan size of $250,000. Allowing for smaller loans may increase the number of businesses that wish to participate in the Program. However, managing intake and credit administration during the life of the loan for many thousands of small loans would require significant additional operational capacity on the part of lenders. In addition, the fixed costs for both borrowers and lenders of legal and accounting fees and administration costs of originating and administering loans would be very high as a percentage of the loan amount for smaller loans. The additional volume and the costs of originating smaller loans could therefore reduce lenders' willingness to participate in the Program.

We will continue to monitor credit conditions for small businesses to determine if additional adjustments to the Program are needed.[15] And the Federal Reserve will continue to assess the optimal arrangements for administering programs, in the public interest.

Question 11: Has the Federal Reserve analyzed whether decoupling lender fees from loan size could better incentivize lenders to identify and onboard smaller borrowers? Please explain whether the Federal Reserve believes higher fees for smaller-size loans could better incentivize lenders to originate loans.

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[15] To date, there has been limited uptake for loans near the Program's $250,000 minimum loan size.

The fee structure on each of the Main Street facility loan products is a fixed percentage of the principal amount of the loan at the time of origination or upsizing. The fee is designed to cover costs of underwriting the loan and incentivize eligible lenders to participate in the Program. Linking fees to loan size is also a standard industry practice. While higher fees for origination of smaller loans may provide some incentives to lenders, higher fees would also place additional burden on smaller borrowers. Changes of this type would need to be considered in terms of their overall effect on Program operations and efficacy; in this regard, it may be useful to assess the potential benefits and costs of such adjustments relative to adjustments to other government programs to support lending to small businesses that have the experience and expertise to execute such programs quickly and effectively.

As with other aspects of Main Street, we will continue to monitor the efficacy of the fee structure and will make adjustments as necessary.

Question 12: Were the MSLF affiliation rules to be relaxed, what would prevent private-equity companies from transferring wealth out of the borrowing business to the private-equity sponsor, and what kinds of restrictions would prevent such wealth transfers?

To determine eligibility for Main Street, a business must aggregate the employees and 2019 revenues of the business itself with those of the business's affiliated entities in accordance with the affiliation test set forth in 13 CFR 121.301(f) (1/1/2019 ed.). This affiliation test applies to private equity-owned businesses in the same manner as any other business subject to outside ownership or control. As a result, some businesses owned by private equity companies are not eligible to participate in Main Street, or are otherwise constrained in the amount they can borrow due to maximum loan size restrictions on borrowing by an affiliated group.

Should such restrictions be amended, and a greater share of businesses affiliated with private-equity companies become eligible borrowers, restrictions on capital distributions and the repayment of debt owed to private-sector lenders would limit the ability of such businesses to transfer funds to the private-equity sponsor.

Question 13: Were the MSLF to be expanded to include an asset-based lending facility, how would the Federal Reserve ensure that assets are appropriately appraised, particularly in light of the significant uncertainty surrounding how COVID-19 will impact commercial propriety values? Would the Federal Reserve be equipped to oversee and enforce appraisals, so that taxpayers are not on the hook if private parties' appraisals turn out to be overvalued?

Main Street currently focuses on cash flow-based lending, for which adjusted earnings before interest, taxes, depreciation, and amortization (EBITDA) is a key underwriting metric used by lenders in evaluating the credit risk of small and medium-sized businesses. The Federal Reserve recognizes that, for some borrowers, collateral values or other factors are more indicative of the ability to obtain credit than cash flows. Staff continue to monitor lending conditions broadly. If credit conditions for collateral-based borrowing deteriorate or other factors indicate strains on borrowers or lenders in these markets, the Federal Reserve would carefully evaluate whether its authorities could support the availability of credit.

If conditions warrant adjusting Main Street in a manner that relied on collateral values as a complement or replacement to the ratio of debt to adjusted EBITDA in determining maximum loan size, the Program would need to have features to protect taxpayers against losses. Among these features would be the amount of collateral required and how such collateral would be valued. Analysis of these issues would be important before establishing such a loan option.

Question 14: Were the MSLF to be expanded to include an asset-based lending facility, would the Federal Reserve be prepared to foreclose on assets if the borrower lacks the cash-flow to make loan payments? How would the Federal Reserve administer foreclosures?

If conditions warranted adjusting Main Street in a manner that relied on collateral values as a complement or replacement to the ratio of debt to adjusted EBITDA in determining maximum loan size, the Program would need to have features to protect taxpayers against losses. Among these features would be the process for recovering value from collateral in the event of default. Analysis of these issues would be important before establishing such a loan option.[16]

[16] In connection with the existing Main Street facilities, the Federal Reserve has stated that, consistent with Section 13(3) of the Federal Reserve Act and the Federal Reserve's obligations under the CARES Act, the Main Street SPV will make commercially reasonable decisions to protect taxpayers from losses on Main Street loans and will not be influenced by non-economic factors when exercising its rights, including with respect to a borrower that is the subject of a workout or restructuring.

August 31, 2020

Via Electronic Mail

Commissioner Ramamurti
Congressional Oversight Commission

Re: **Follow-up Question from Hearing on August 7, 2020 Examination of the Main Street Lending Program Established by the Federal Reserve Pursuant to the CARES Act**

Dear Commissioner Ramamurti:

The Bank Policy Institute appreciated the opportunity to be a witness before the Commission on August 7, 2020 and we thank you for your follow-up question and continued engagement regarding the Main Street Lending Program (MSLP). With regard to your specific question, please find our response below.

I. Do lenders collect demographic data on borrowers in the absence of federal program mandate to collect and report such data? If not, will BPI commit to working with its members to collect such demographic data for MSLP loans?

BPI is not specifically aware of BPI member banks collecting demographic data on MSLP applicants or MSLP borrowers who ultimately receive funds under the Program.

Given BPI member banks represent less than 10% of registered lenders it may be more appropriate for such data to be systematically collected by the Federal Reserve Bank of Boston to get a more accurate picture of loan distribution across demographics. BPI member banks would of course be willing to work with the Federal Reserve Bank of Boston to determine how best to capture such data through the portal process.

Alongside working with the Federal Reserve Board, the Federal Reserve Bank of Boston and the Treasury to ensure the MSLP is reaching LMI communities and minority-owned businesses, BPI banks are very committed to serving such communities and businesses. For example, about four-in-ten PPP loans originated by large banks went to businesses in low- to moderate-income or predominantly minority areas, according to a recent BPI survey of its largest member banks.[1] Additionally, BPI members are partnering with Community Development Financial Institutions and Minority Depository Institutions to better support financial inclusion and minority entrepreneurship and success. As a result, BPI is supportive of efforts in Congress to expand investments in CDFIs and MDIs, including legislation that would provide long term equity to these institutions to deliver further support to underserved borrowers and borrowers in minority communities.

* * * * *

Bank Policy Institute appreciates the opportunity to engage with the Commission. If you have any questions, please contact the undersigned by phone at 202-737-3536 or by email at Lauren.Anderson*@bpi.com.*

Respectfully submitted,

Lauren Anderson
Senior Vice President and Associate General Counsel
Bank Policy Institute

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[1] *See* "Large Banks Are Serving the Credit Needs of Small Businesses in Low- and Moderate-Income and Minority Communities Through the Paycheck Protection Program," (June 22, 2020); *available at* https://bpi.com/press-releases/large-banks-are-serving-the-credit-needs-of-small-businesses-in-low-and-moderate-income-and-minority-communities-through-the-paycheck-protection-program/

Appendix H:
Charts and Tables Referenced in Analysis Section of This Report

Chart 1 (Shalala and Ramamurti): Municipal Bond Spreads over Treasuries by Rating Category

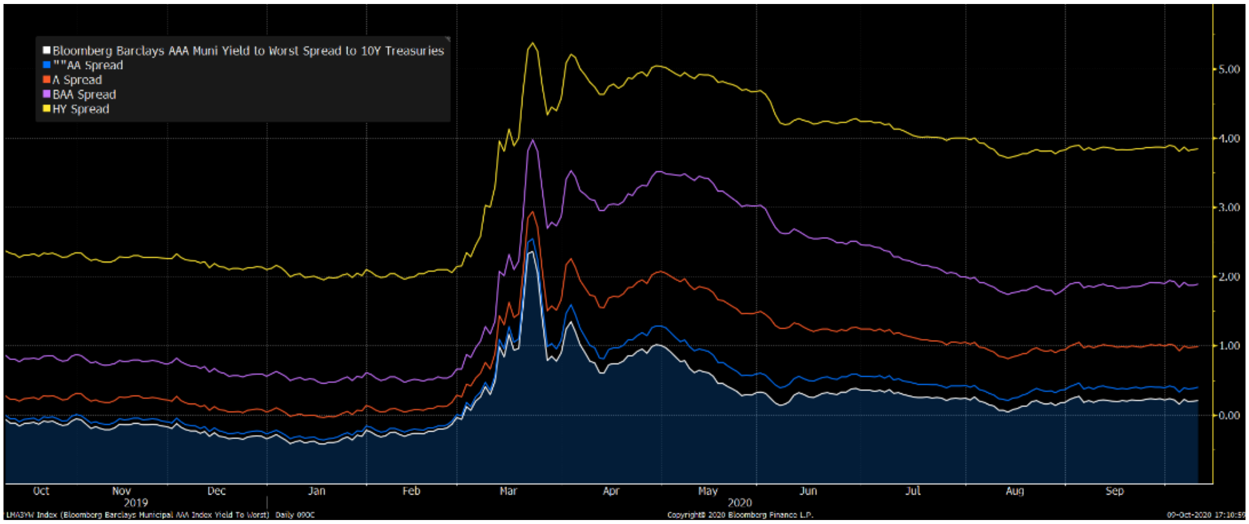

Chart 2 (Toomey and Hill): Municipal Bond Market Yields by Rating Category

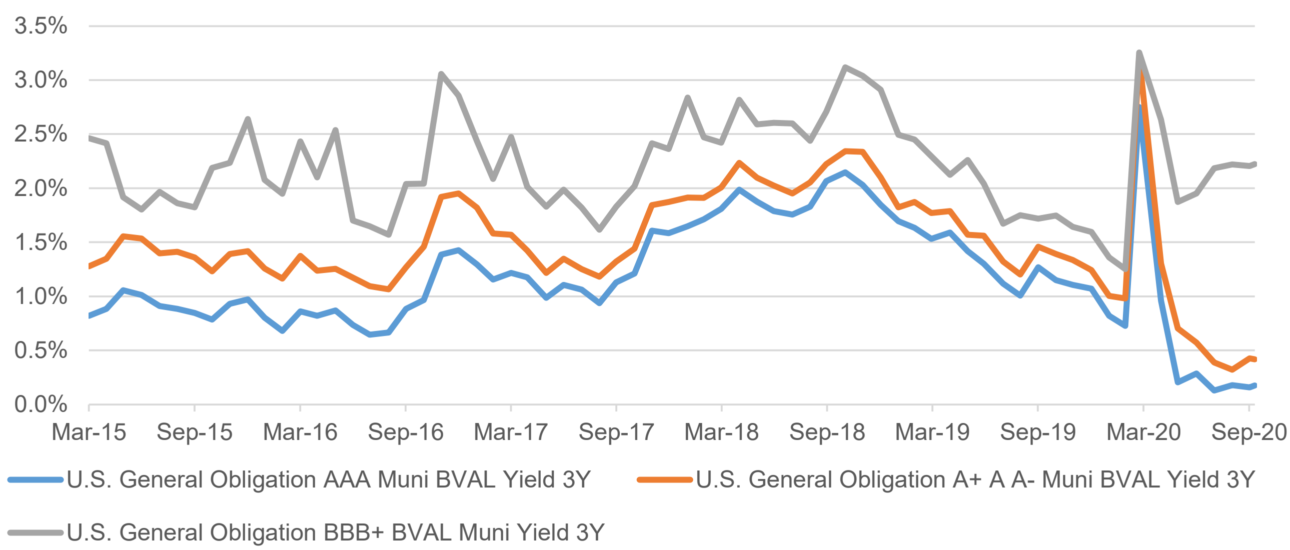

Chart 3 (Toomey and Hill): AAA Municipal Bond 5- and 10-Year Yields

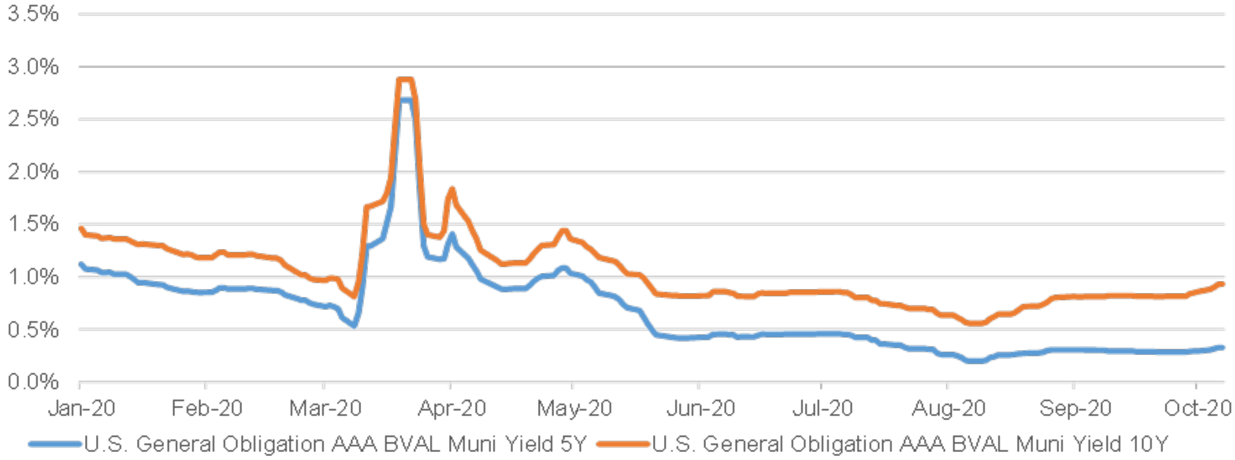

Chart 4 (Toomey and Hill): Municipal Bond Yields Compared to MLF Indicative Rates Before and After COVID-19 Market Stress

Chart 5 (Toomey and Hill): AAA Municipal Bond Yields Relative to Fed Announcements

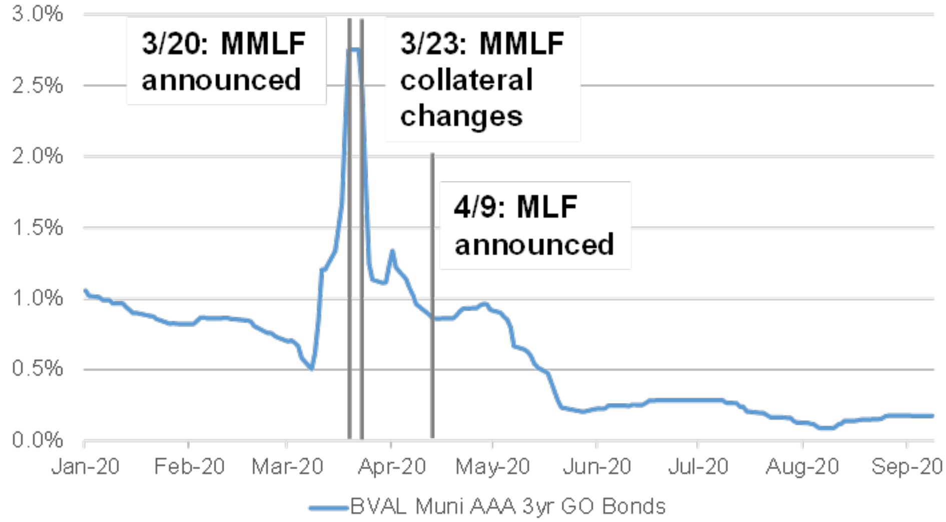

Chart 6 (Toomey and Hill): AAA Corporate Bond Yields Compared to Municipal Bond Yields

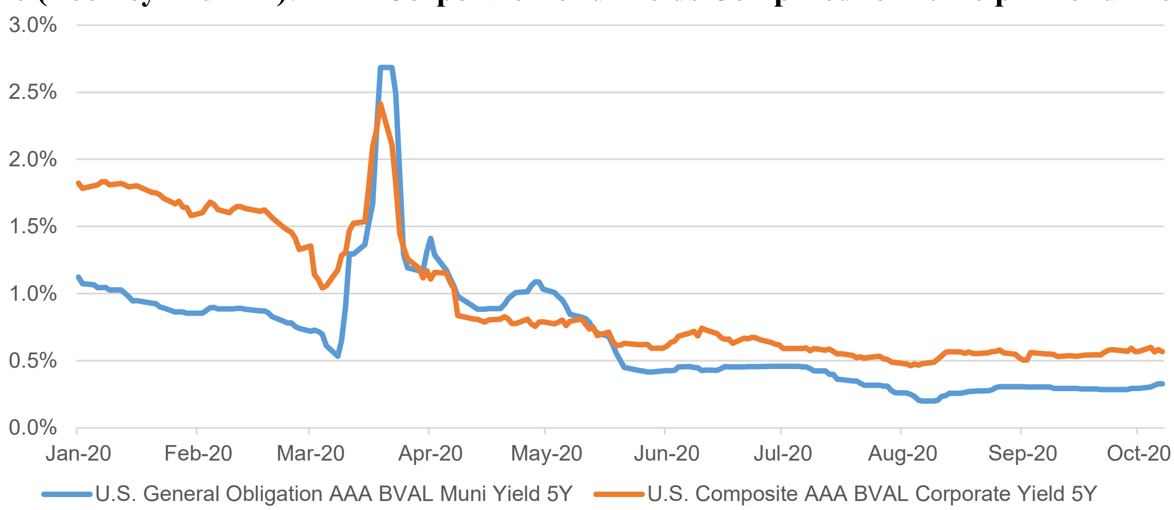

Table 1 (Toomey): MTA Overtime Spending from 2019 Morrison Foerster Report

Year	MTA Overtime Spending (in $ Millions)
2020	896 (budgeted)
2019	1,260
2018	1,380
2017	1,200
2016	971
2015	942
2014	849

Appendix I:
Preliminary Transcript of Municipal Liquidity Facility Hearing on September 17, 2020

EXAMINATION OF THE MUNICIPAL LIQUIDITY FACILITY ESTABLISHED BY THE FEDERAL RESERVE PURSUANT TO THE CARES ACT

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THURSDAY, SEPTEMBER 17, 2020

Congressional Oversight Commission,

Washington, D.C.

The Commission met, pursuant to notice, at 10:02 a.m., in Room SD-215, Dirksen Senate Office Building, and via Webex, Hon. Donna Shalala, Acting Chairman, presiding.

Present: Representative Shalala, Mr. Ramamurti, Representative Hill, and Senator Toomey.

OPENING STATEMENT OF MS. SHALALA

Ms. Shalala. This hearing will come to order. This is a hybrid hearing, meaning that our Commissioners are appearing in person and witnesses will testify remotely.

Before I begin introducing our witnesses, let me first offer a few videoconferencing reminders. Once you start speaking, there will be a slight delay before you are displayed on the screen. To minimized background noise, please click the "Mute" button until it is your turn to speak or ask questions. If there is a technology issue, we will move to the next speaker until it is resolved.

You should all have one box on your screens labeled "Clock" that will show how much time is remaining. All members and witnesses need to be especially mindful of the

5-minute clock. At 30 seconds remaining, I will gently tap the gavel to remind members that their time has almost expired.

With that, today we welcome you to this hearing convened by the Congressional Oversight Commission. The Commission's role is to conduct oversight of the implementation of Division A, Title IV, Subtitle A of the CARES Act by the Department of the Treasury and the Board of Governors of the Federal Reserve System. Subtitle A provides $500 billion to the Treasury Department for lending and other investments to, I quote, "provide liquidity to eligible businesses, States, and municipalities related to losses incurred as a result of the coronavirus."

As part of our oversight work, the Commission has decided to hold this hearing today, which will examine the Municipal Liquidity Facility. The Federal Reserve established the Municipal Liquidity Facility to provide up to $500 billion in lending to State and local governments and other municipal issuing authorities.

Today's hearing will have two panels.

Mr. Kent Hiteshew, Deputy Associate Director of the Division of Financial Stability of the Federal Reserve Bank of New York, will testify during the first panel. Mr. Hiteshew also previously served as the first Director of the Office of State and Local Finance at the U.S. Department of the Treasury. Prior to his time at Treasury, Mr. Hiteshew was a public finance banker with JPMorgan and its predecessor firm Bear Stearns. Mr. Hiteshew is a graduate of Rutgers and earned his Master's in City Planning from the University of North Carolina, Chapel Hill.

In the second panel, we will hear testimony from Mr. Patrick McCoy, who is director of finance at the Metropolitan Transportation Authority in New York. Mr. McCoy has also previously served as the executive director of the New York City Municipal Water Finance Authority, the executive director of New York Water, and the deputy director of finance for the MTA. Mr. McCoy earned his Master's degree in Urban Policy Analysis and Management from the New School in New York and has a B.A. from St. Ambrose University.

Mr. Marion Gee is president of the Government Finance Officers Association. In addition, Mr. Gee has served as the finance director of the Metropolitan St. Louis Sewer District since September of 2015. Previously, Mr. Gee was the assistant finance director for the city of San Antonio for 4 years. Prior to joining the city of San Antonio, he was employed as finance director of the Louisville Metropolitan Sewer District for 11 years. Mr. Gee is a certified public accountant, earned his Master's in Business Administration and his Bachelor's of Science in Business

Administration from the University of Louisville.

Mr. Chris Edwards is the director of tax policy studies at the Cato Institute. Before joining Cato, Mr. Edwards served as a Senior Economist on Congress' Joint Economic Committee. Prior to his time at the JEC, Mr. Edwards was a manager with PricewaterhouseCoopers and an economist with the Tax Foundation. He has authored "Downsizing the Federal Government" and is co-author of "Global Tax Revolution." Mr. Edwards is a graduate of the University of Waterloo and holds a Master's in Economics from George Mason University.

Dr. Mark Zandi is the chief economist at Moody's Analytics. Dr. Zandi is on the board of directors of the Mortgage Guaranty Insurance Corporation and serves as the lead director of the Reinvestment Fund, which makes investments in underserved communities. Dr. Zandi is the co-founder of Economy.com, which provides economic analysis data and forecasting, credit risk services, and research on countries, industries, and economies. Dr. Zandi is also the author of "Paying the Price: Ending the Great Recession and Beginning a New American Century" and "Financial Shock." Dr. Zandi is a graduate of the Wharton School of the University of Pennsylvania and earned his Ph.D. at the University of Pennsylvania.

We are fortunate to have these five witnesses appearing today and appreciate their time. The Commission would like to note for the record that it also invited the Treasury Department to participate in the hearing, but the Treasury Department declined.

In the absence of a Chair, the Commission have agreed to each have 1 minute of opening remarks. I will now recognize myself for an opening statement.

It is no secret that State and local governments are struggling to deal with the economic fallout of COVID-19. They have already cut 1.1 million jobs. The city of Miami in my district, Florida's 27th, has an estimated budget shortfall of nearly $25 million, and the pandemic is not even over yet.

Miamians did not cause this problem. We were actually very prudent. We saved and we went into the pandemic with a $20 million surplus. COVID-19 wiped that out, and now we face a huge deficit.

South Florida's economy relies on tourist dollars, but the tourism industry has been decimated. And while our revenues are down, our expenses are up. We need to pay for PPE to protect our first responders and update school programs to keep our children safe. This problem is not unique to Miami. It is happening all across the country.

The Municipal Liquidity Facility can support $500 billion in lending, but to date only $1.65 billion, less than 1 percent, is being used. I hope we come up with solutions today to get State and local governments the support they need and their residents desperately need.

I yield back. I yield to Senator Toomey.

OPENING STATEMENT OF SENATOR TOOMEY

Senator Toomey. Thank you, Madam Chair. Let me just say, some who criticize the Municipal Liquidity Facility may be ignoring its original intended purpose. The CARES Act was meant to resolve the immediate liquidity crunch and economic shock experienced in March of 2020.

The Municipal Liquidity Facility was not meant to replace private capital markets, be a mechanism to bail out State and local governments, nor to be a substitute for fiscal policy. As the name implies and consistent with Section 13(3) of the Federal Reserve Act on which the CARES Act was built, the Municipal Liquidity Facility was meant to be a lender of last resort, to stabilize the municipal bond market, and to provide liquidity.

These were unprecedented actions, and the economy today is in a very, very different place now than it was 6 months ago. State and local revenue shortfalls are far less than what was originally projected. The municipal bond markets have recovered. Municipal bond issuance is higher, up 21 percent year over year through August, as opposed to the down 30 percent of March. And, importantly, municipal interest rates and spreads have returned to their pre-COVID-

19 levels.

Economic data is coming in with greater strength than many had forecast, and using this program to do anything more than what it was intended to do, which was the provide temporary liquidity, would, in my view, be inconsistent with congressional intent when it passed the CARES Act. Liquidity in the municipal bond market has been restored, and as such, the MLF, in my view, should wind down.

Ms. Shalala. Thank you, Senator Toomey.

I now recognize Mr. Ramamurti for 1 minute.

OPENING STATEMENT OF SENATOR MR. RAMAMURTI

Mr. Ramamurti. Thank you, Madam Chairwoman.

In the 6 months since Congress authorized the Treasury and the Fed to offer loans to State and local governments, they have provided two loans for a total of $1.65 billion. That is 0.3 percent of the $500 billion lending capacity of the program.

State and local governments are desperate for help, but the loans offered by this administration are so punitive that even governments in deep trouble cannot justify using them. Yet at the same time, the Treasury and the Fed are offering much more generous no-strings-attached support to many of America's biggest and most profitable corporations. It is a shameful disparity that reflects this administration's priorities, taking care of big-time executives and wealthy shareholders while abandoning emergency responders, teachers, firefighters, nurses, and all the people who count on their help; and it will further widen the racial income and wealth gaps in this country.

Congress needs to provide direct aid to State and local governments immediately, but if Republicans continue to stonewall direct aid, the Fed and the Treasury should offer much more generous loans so that State and local governments can help families, protect jobs, and support our economy.

Thank you, Madam Chair.

Ms. Shalala. Thank you.

Commissioner Hill.

OPENING STATEMENT OF MR. HILL

Mr. Hill. Thank you, Madam Chair, and thank you to our witnesses for providing your expertise today.

Today we are discussing the Municipal Liquidity Facility. This continues to be a heated topic on Capitol as State and local municipalities determine how best to balance their budgets and fight COVID-19.

Last week, in the House Financial Services Committee we held a hearing precisely on this issue. This challenge varies widely across the Nation. During the hearing last week, I highlighted that the number of COVID cases per State does not correlate with how an individual State's economy is actually faring.

For example, Arkansas and New York are ranked very similarly in the number of COVID-19 cases per capita, but sales tax revenue in my home State of Arkansas is up substantially while down in New York. I will discuss this in more detail.

Ultimately, we need to ensure that our communities can reopen in a safe and secure manner and rebuild our great economy that we experienced at the beginning of this fateful year.

Thank you, Madam Chair, and I yield back.

Ms. Shalala. Thank you, Congressman Hill.

All members' statement will be added to the hearing record. Each of the witnesses' full written testimony will also be made part of the official hearing record.

To allow the members enough time for questions with each witness, we have organized today's hearing into two panels. Mr. Hiteshew of the Federal Reserve will testify in the first panel, and Mr. McCoy, Mr. Gee, Mr. Edwards, and Dr. Zandi will testify in the second panel.

We will now proceed with the first panel and hear Mr. Hiteshew's testimony. At the end of his testimony we will move to two rounds of 5-minute questioning.

Mr. Hiteshew, welcome. You are now recognized for 5 minutes.

STATEMENT OF KENT HITESHEW, DEPUTY ASSOCIATE DIRECTOR, DIVISION OF FINANCIAL STABILITY, BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM

Mr. Hiteshew. Good morning, Madam Chair, Representative Hill, Commissioner Ramamurti, and Senator Toomey. Thank you for the opportunity to speak with you about the Federal Reserve's Municipal Liquidity Facility. I am very pleased to provide information that I hope will be useful to your important oversight work.

At the outset of the COVID pandemic in mid-March, the $3.9 trillion municipal bond market experienced historic levels of turmoil. Market conditions unprecedented--far worse than during the onset of the financial crisis in late 2008 or even in the days after 9/11, when the municipal market was briefly closed. Interest rates soared more than 225 basis points in just 9 trading days, mutual fund investors pulled over $41 billion of assets out of the market in less than 3 weeks, and market functioning deteriorated to the point that buyers and sellers had difficulty even determining prices. Ultimately, this meant that State and local governments were effectively unable to borrow, with new issues canceled for lack of investor demand.

Recognizing the severity of this market dislocation, the Federal Reserve quickly moved to use its authorities to directly support the municipal markets for the first time in its 100-year history.

First, the inclusion of municipal variable rate demand notes as eligible collateral in the Money Market Liquidity Fund on March 23rd had an immediate and dramatic downward impact on short-term municipal rates, providing both significant interest cost relief to State and local budgets and increased liquidity to the larger fixed-rate municipal market.

Next, on April 9th, the Fed, with the approval of the Treasury, announced the MLF to help State and local governments better manage the extraordinary cash flow pressures associated with the pandemic--caused by both higher expenses of fighting COVID on the front lines and sharply delayed and lower tax revenues from the resulting economic recession. The facility backstops private market capacity to address these liquidity needs by standing ready to purchase the short-term notes often used by State and local governments to manage their cash flows. By addressing the cash management needs of eligible issuers, the MLF was also intended to encourage private investors to reengage in the municipal securities market, thus supporting overall municipal market functioning. With nearly 20 million employees--that is 13 percent of all employees in the Nation--and the responsibility for delivering essential services to their constituents, the fiscal stability of State and local governments is a crucial component of the Nation's overall economic health and its recovery. As of August 31, the facility had purchased two issues for a total outstanding amount of $1.65 billion.

Consistent with the Fed's Section 13(3) authority, our mandate is to serve as a backstop lender to accomplish these objectives--not as a first stop that replaces private capital. Accordingly, we have established MLF pricing based on a rate that is a premium to normal market conditions as measured over an extended period prior to the pandemic, but at a discount to stress conditions in March.

We are also required to protect the taxpayer against loss. We cannot make grants or forgivable loans, and we cannot lend to insolvent or highly distressed entities. Therefore, we measure the success of the MLF based not on its volume of lending but, rather, on the condition of the municipal securities market and State and local government access to capital.

By these measures, the MLF has contributed to a strong and rapid recovery in the municipal securities markets. State and local governments and other municipal bond issuers of a wide spectrum of types, sizes, and credit ratings have been able to issue securities, including long maturity bonds, with interest rates that are at or near historic lows.

Many State and local governments have taken advantage of these low rates to refinance their outstanding debt for substantial debt service savings, with a resulting record issuance of $225 billion of bonds since April 1st. And those municipal issuers that do not have direct access to the MLF have still benefitted substantially from this better-functioning municipal market.

Of course, the Federal Reserve continues to closely monitor the municipal markets and State and local government borrowing conditions and their access to capital, and we remain vigilant to any dislocated conditions. We look forward to answering your questions today, and I thank you very much for this opportunity.

[The prepared statement of Mr. Hiteshew follows:]

Ms. Shalala. Thank you very much.

As I mentioned in my opening remarks, the Municipal Liquidity Facility can support up to $500 billion in lending. However, thus far, only two issuers have borrowed a combined total of $1.65 billion, which represents less than 1 percent of the facility's total capacity. Does the facility's non-use indicate a design flaw of the program?

Mr. Hiteshew. Thank you for that question, Madam Chair. We do not think so. This is the first time that the Fed has intervened in the municipal market. It is a complex market made up of 50,000 unique issuers of various sizes, types, purposes, and credit ratings, as I mentioned.

We had to undertake very quickly to enter into the market, and our four principles that were guiding us in terms of our design were: speed to announcement and execution; do not let the perfect be the enemy of the good; ensure that State and local governments had access to liquidity for operating cash--this is what we heard overwhelmingly from individual issuers and associations like GFOA; restore market confidence and stability given the unprecedented liquidity crisis in the market; and, finally, to your point, to design a uniformly applicable, transparent, and easy-to-administer facility.

We started out on April 9th with the core program announcement. We made several changes along the way. As the Chair cites, we are learning as we go here, and we have made these adjustments. But in the meantime, we have experienced--and we think this is due to the totality of the Fed's various facilities. There has been a sharp recovery in the municipal market, and access to the markets has been opened, and notwithstanding the two loans that were made in the MLF, there is broad access to the market, as I mentioned in my opening comments, at historically low interest rates.

So we think the program has been successful. The mere size of the announcement of the program, the $500 billion, had an immediate positive impact. How did that happen? Because long-term investors were comforted that the Fed was standing by to meet the liquidity needs of State and local governments to make sure that they did not run out of cash and they did not default for liquidity purposes as opposed to for credit concerns.

Ms. Shalala. Thank you. I do have another question.

Mr. Hiteshew. Sure.

Ms. Shalala. Many potential borrowers and commentators, including three of our four witnesses today in our second panel, believe that the terms of the Municipal Liquidity Facility are too restrictive. The interest rate is too high; the 36-month term is too short; and the use of loan proceeds are overly constraining. We understand that the Federal Reserve lends at a penalty rate and views itself as the lender of last resort. But it also has the discretion to determine what an appropriate penalty should be.

Given the needs expressed by State and local governments experiencing economic crisis, why did the Fed establish stringent terms that render the program unapproachable for most borrowers?

Mr. Hiteshew. We do not believe that the program is rigidly designed. We believe that it is carefully calibrated to meet the purpose of the program. Our pricing is based on the methodology that is grounded in Federal statute, regulation, and our longstanding principles, as adopted by Regulation A in 2015 by the Federal Reserve after a 2-year rulemaking process that included broad public support across the ideological spectrum for the imposition of a premium rate in 13(3) loan facilities.

We have adjusted that rate once over the summer as we saw the municipal market rally, and we wanted to make sure that the backstop continued to provide its intended purpose and to make sure, if there should be a sell-off in the future, that we were tighter to current market rates. So we have been flexible in terms of pricing.

In terms of the maturity, Madam Chair, the purpose of the program is to provide liquidity. Most State and local governments are required, as you know, to have balanced budgets and have very limited capacity to borrow across fiscal years. We wanted to design a program that was applicable to all but that, of course, has to recognize that Federal law cannot supersede local statutes and Constitutions. And so to the extent that issuers have the ability to borrow beyond a year for operating and liquidity purposes, we are available to provide for that. But I think the key is not to look at what the program requirements are but what the results have been in the municipal market. We have State and local governments that are rushing to market to take advantage of interest rates, low interest rates, to achieve significant debt service savings. I believe O'Hare Airport announced a refunding for next week in which the target is 20 percent savings on their bond.

Ms. Shalala. Thank you.

I yield back and turn to Senator Toomey for 5 minutes of questioning.

Senator Toomey. Thank you, Madam Chairman.

Mr. Hiteshew, I think, if I heard you right, when you were discussing how the program--how the pricing works, you said that the pricing by design is meant to be at a premium in terms of the cost to the prior, what I would consider ordinary conditions, but a discount to stressed levels. So, by design, is it fair to say that if the market were to return to something like the prior ordinary conditions, then a typical borrower would be able to go back to the market and access credit at more attractive terms than the MLF offers, and that that is, in fact, exactly what we have seen?

First of all, was that the idea? And, secondly, could you characterize a little bit more the municipal bond market today, the volume, the types of issuers that are able to access it? What is pricing like for these issuers? And as a general matter, what is the availability of credit for municipalities?

Mr. Hiteshew. Thank you, Senator. In fact, you may know that your home State, the Commonwealth of Pennsylvania, borrowed over $400 million yesterday in the marketplace for 20 years at an average interest rate of 1.93. So that is one indication of where rates are.

By design, based on the Fed's monopoly muni rates are near zero after having approached nearly double digits. The MTA and other issuers in March had variable rate debt that was pricing, as I said, in the high single digits. Today those are at zero. Three-year rates are generally less than 75 basis points. The triple A curve is about 20 basis points at that point. Thirty-year rates with the triple A curve is at 160, generally with a spread for a double layer or single layer issue you are going to come in at under two and a half.

Senator Toomey. And can I just interrupt briefly for a quick clarification? So those sound like extremely attractive rates, certainly by historical standards. Are they generally available to issuers?

Mr. Hiteshew. They are. As I mentioned, we have experienced record issuance since the recovery began in April, and, again, with interest rates so low, issuers are even issuing significant amounts of taxable debt in order to refinance tax-exempt that the tax rules do not allow them to otherwise do.

Senator Toomey. Because interest rates are so low.

Mr. Hiteshew. That is correct.

Senator Toomey. Yeah. Quickly, because I am going to run out of time here, the program by design is available to municipalities above a certain size. What does the program offer to municipalities that are too small to meet that threshold?

Mr. Hiteshew. The program was designed, again, balancing the need to rush to market, to have a perfect program that came too late would not have been of help to the municipal market. So we had to make decisions, as I said, with 50,000 issuers. So we focused on the large ones at first. We slowly increased the number. But the benefit to all the issuers is that the market has recovered, and the vast majority of issuers have access at extraordinarily low rates.

We also developed a feature that allows downstreaming so that States and larger cities and counties have the ability to borrow on behalf of their sub-entities if necessary.

Senator Toomey. So States can be a conduit for the smaller municipalities within their borders.

Mr. Hiteshew. Correct.

Senator Toomey. Some have suggested that--you know, we have got two facilities for corporate debt. We have got the primary facility, and we have a secondary market facility. But yet we only have one that is explicitly meant for the municipal debt and that there is an inherent unfairness to that. But wouldn't it be fair to say that the Money Market Mutual Fund Liquidity Facility effectively serves as a tool to provide liquidity in the secondary market for municipal debt?

Mr. Hiteshew. Certainly a certain type of municipal debt, commercial paper programs supports commercial paper, tax-exempt commercial paper. And the MMLF, the Money Market Fund, supports the RDBs. And as I have noted, in particular, that second program had an enormously positive impact.

In terms of the secondary market, we are very cognizant of the differences in the markets, and munis are very different than corporates, as I think everybody here understands, with the number of issuers and the diversity and the idiosyncratic nature of the marketplace and the relative illiquidity in the marketplace compared to corporates and other markets.

So our thought was--and we were driven by what we were hearing from State and local issuers--get liquidity available to us as soon as possible, and we wanted to do that and also restore market confidence. We thought that designing a secondary market program for munis would have taken longer. Munis, as you may know, have very little ETFs in it, and the secondary market for corporates is largely being executed through the purchases of ETFs.

So while a secondary market facility could have been developed for the muni market, we believe that MLF was better suited and easier and quicker to get into the marketplace. If we had needed a secondary market facility, we have that capability. But we believe at this point that is not necessary, and we hear from market participants regularly. Every day we are talking to market participants, and we have not heard that they believe one as well. That is the opposite. They do not believe a secondary market facility in munis at this time is necessary.

Ms. Shalala. Thank you.

Mr. Hiteshew. But, of course, we remain vigilant in terms of changes to markets.

Ms. Shalala. Thank you.

Commissioner Ramamurti.

Mr. Ramamurti. Thank you, Madam Chair.

State and local governments have been hit hard by the COVID-19 crisis, and they are desperately looking for help. Despite that, we have seen report after report of State and local governments taking a look at the loans offered through the Fed's lending program and deciding that they cannot justify taking on such harsh terms. Instead, they are moving forward with sharp budget cuts, cuts to our kids' schools, to housing, to nutrition programs, and more.

Mr. Hiteshew, you are leading the Fed's efforts on this lending program, so I want to understand why you have chosen to make the loans as punitive and unappealing as you have, particularly in comparison to what the Fed is offering corporate America. So let me give you an example. Through its Corporate Credit Program, the Fed has purchased a bond issued by Philip Morris that pays about 0.075 percent interest over a term of more than 4-1/2 years. But the Fed is requiring the State government, like Kentucky, which has the exact same credit rating as Philip Morris, to pay an interest rate of more than 2 percent over 3 years--in other words, a rate more than double what Philip Morris is paying, despite a shorter loan term.

So, Mr. Hiteshew, why is the Fed demanding such a high rate from our own State governments when it is willing to accept such a low rate from a company like Philip Morris?

Mr. Hiteshew. Well, Commissioner, you and I both agree that the serious condition of State and local government balance sheets needs to be addressed, and we believe that monetary policy has limited capacity to do that, and as the Chair has said on numerous occasions, believes that we will need more fiscal policy to get through this situation.

With regard to your specific example, I think there may be a little bit of apples and oranges there, and I believe that you are citing the Secondary Market Corporate Credit Facility. The analog to the muni market is the Primary Corporate Credit Facility for which there have been zero loans made to this point.

Mr. Ramamurti. Well, respectfully, Mr. Hiteshew--and, again, sorry to cut you off, but my time is limited. Look, the Secondary Market Corporate Credit Facility is set up under Section 13(3). It is subject to the exact same rules and regulations as the Municipal Liquidity Facility, and yet there seems to be no penalty rate for corporations, but there is a significant penalty rate for State and local governments, and that is having a serious impact on the functioning of that facility. And, look, there are dozens and dozens of these examples.

Just to give you one more, currently the Fed is using public money to purchase a bond from Chevron at a rate of about 0.09 percent over more than 4-1/2 years while a State like Wisconsin with the exact same credit rating as Chevron has to pay 1.28 percent over 3 years--again, a substantially higher rate despite a shorter term.

So, look, there are two main variables here that affect how punitive these loans are: the interest rate and the length of the repayment term. And I want to understand if there is anything stopping you from making each of these variables less punitive for State and local governments.

So on the rates, as you noted, the Fed has already dropped the interest rates offered to State and local governments by half a percentage point, which means that you were not offering the lowest possible rates before. Is there anything legally that prevents you from reducing the rates further so that they are comparable to what corporations are getting from the Fed?

Mr. Hiteshew. Again, Commissioner, corporations are the Secondary Market Program that you are citing. The Primary Market and the Main Street Facilities both have premiums that are established--

Mr. Ramamurti. Mr. Hiteshew, can you answer very simply? Is the Secondary Market Corporate Credit Facility subject to the same 13(3) authority as the Municipal

Liquidity Facility?

Mr. Hiteshew. It is. I am not--

Mr. Ramamurti. So why is there a difference on the penalty rate?

Mr. Hiteshew. I would like to answer by saying that I am not an expert on the Secondary Market Facilities. We would be glad to put together a call with you with our General Counsel, but they are subject to Reg A. They are in compliance with Reg A in a different manner than open market lending.

Mr. Ramamurti. Okay. And I am sorry to cut you off, just because I want to keep moving with my time, and I will take you up on that offer. It sounds like potentially there is an opening here given what you have said.

Here is another example: the repayment term. The lending facilities for mid-sized companies--and, again, these are primary market loans--have a term of 4 or 5 years while the State and local lending program only allows 3-year repayment terms. Is there any explicit legal restriction that stops you from extending the repayment term to 5 years like the corporate facilities offer?

Mr. Hiteshew. There is no legal limitation. We have programs that are designed for different markets to reflect the differences in those markets.

Mr. Ramamurti. How about 10 years? Is there anything that restricts it from going to 10 years?

Mr. Hiteshew. The program is designed to restore market conditions through making liquidity available to State and local governments. In general, State and local governments have limited authority to borrow for liquidity--

Mr. Ramamurti. Sure, but they could obviously change those laws if the Fed is offering something that is appealing to them.

Look, my time is up. Thank you, Mr. Hiteshew. It sounds like there is no legal restriction that is stopping you from making these terms much more generous. I do not think the Treasury and the Fed should be treating State and local governments worse than big corporations. There is no justification for it legally. There is no justification for it economically. And I hope that the Fed and the Treasury will move quickly to fix these problems.

Thank you, Madam Chair.

Ms. Shalala. The gentleman yields back. Thank you.

Congressman Hill is recognized for 5 minutes.

Mr. Hill. Thank you, Madam Chair.

Mr. Hiteshew, you mentioned in your testimony the market has largely stabilized from the levels that we saw in April, and that was largely due to the announcement of the MLF. Is that correct?

Mr. Hiteshew. Yes. I would just correct that a little bit by saying I think you have to look at the totality of the Federal Reserve interventions in all the markets. But, certainly, the MLF together with the MMLF and the CP program all had positive impacts on the muni market.

Mr. Hill. And to date, the Metropolitan Transportation Authority of New York, who we will hear from in a few minute, and the State of Illinois have participated in the program. Are there others that you know of that plan on taking advantage of the MLF?

Mr. Hiteshew. Congressman, as a matter of policy, we do not disclose applicants until the loans are purchased. But there is plenty of--

Mr. Hill. What is your pipeline right now, would you say, in terms of either numbers or dollars?

Mr. Hiteshew. Again, we have ongoing daily conversations with issuers across the country, so we are aware of issuers that are interested in the program. We have one specific issuer that has come into the pipeline and may be doing a financing in the next couple of weeks where--

Mr. Hill. Thank you.

Mr. Hiteshew. --the notes may or may not be purchased, depending on, again, market management.

Mr. Hill. I understand.

Mr. Hiteshew. Beyond that, there are a number of other major issuers that are contemplating the program.

Mr. Hill. Thank you. Do you believe the 12/31 deadline for the expiration of this facility should be extended?

Mr. Hiteshew. That is a call for the Board and the Secretary of the Treasury to make as we get closer to the end of the year. As you know, the Municipal Facility was the first facility to be extended from September 30th to December 31st. And while we are not by any means projecting that we will see any kind of market turbulence like we saw in March, there are warning signs in the muni market that we should all be aware of. The coming cuts and potential downgrades of State and local governments could affect market conditions, and so we remain vigilant, and we believe that through the end of the year, at a minimum, this is an important facility to, again, backstop the market, provide confidence to the market so that all issuers, whether they are directly eligible or not, have access to affordable capital.

But as we get closer to the end of the year, that will be a determination that the Board and the Secretary will make based on what market conditions look like at that point.

Mr. Hill. Thank you very much.

Mr. Hiteshew. As they will with all the facilities.

Mr. Hill. Chairman Powell has been vocal over the months working with us that the Fed is learning as they go when it comes to designing and implementing these 13(3) facilities. And as noted, on August 11th, the Fed lowered the interest rate by 50 bps on the Municipal Liquidity Facility, at which point the Metropolitan Transportation Authority in New York, who we will hear from in a few minutes, took advantage of the program, getting a better rate than it could from the street. And this is to Senator Toomey's point. Since this is a backstop program, as you have testified--and this seems to be in direct contradiction to my friend Commissioner Ramamurti in the sense that the MTA rejected 20 private sector bids for $1.6 billion in offers on their bond anticipation notes and took the Fed up on their offer and placed, if my memory is right, about $450 billion at 1.92 percent at the Fed, even though the street's bids were at 2.79. What is your comment on that?

Mr. Hiteshew. Congressman, the MLF does not set pricing for individual loan purchases but, rather, we use a uniform pricing grid based on average credit ratings--

Mr. Hill. I understand that. I have seen the grid, and I understand it. But, obviously, it was to the advantage of the MTA to come directly to the MLF, which seems to contradict my friend. And I am just curious. If the market rate is 2.79, how does that reflect you being a backstop lender as opposed to someone competing with the private sector?

Mr. Hiteshew. Again, the facility is uniformly applicable and broadly available to eligible issuers, and so on that particular day, that was the result of the competitive bidding process that the MTA undertook. And we are an open lending window, and that was the rate that the MTA qualified for, and that was their decision. Again, yes, we act as a backstop, but, again, with the number of issuers in the marketplace, there will be different prices on different days for different issuers.

Mr. Hill. Thank you, Madam Chair. I yield back.

Ms. Shalala. Thank you. We will now start the second round of questioning by the Commissioners.

In June, the Federal Reserve lent $1.2 billion to the State of Illinois through the Municipal Liquidity Facility. An economist on our second panel, Mr. Edwards with the Cato Institute, testified it is not appropriate for the Nation's central bank to finance the States because, in his judgment, the States have a large independent fiscal power to tax, save, borrow, and adjust spending. His testimony goes on to say that the MLF is an unneeded central bank expansion into State budget policy.

Do you agree with these statements? Why or why not?

Mr. Hiteshew. The Municipal Liquidity Facility is designed to not only provide liquidity to State and local governments in an emergency situation, but it is also designed to restore market confidence. I think that 6 months since the events, those folks who are not as active in the municipal market cannot appreciate the stress that that market was under in March. You have got two issuers on your next panel that can testify to their day-to-day heightened concerns about maintaining their market access during that period of time. And so the MLF has had an enormously important contribution to make to stabilizing the markets for all issuers, and I would not want to comment on his point about the appropriateness of the lending to locals on an individual basis. This is a broad program that is applicable on a uniform basis. We do not pick individual issuers. If you are eligible and you meet the eligibility criteria, you have access to this facility. By design, that is what makes it such a powerful facility.

Ms. Shalala. Actually, it is not so powerful if only 250 entities are eligible to directly access a facility, and the vast majority of nearly 80,000 public issuers are left out, with the exception that Governors can designate a couple of local governments, which actually pits them against one another when they should be instead working towards common goals.

Why is the Federal Reserve imposing such restrictive limitations to access when over 99 percent of the facility remains unused? Why are you just so restrictive to just a handful of municipals?

Mr. Hiteshew. Great question, Madam Chair, and I think it goes back to my point about speed to announcement and execution and the complexity of trying to set up a Federal lending window for 50,000--you said 80,000--unique issuers with a wide spectrum of sizes, types, purposes, and credits. So our goal was to identify some of the largest issuers, a signal to the marketplace that those issuers would have full access to liquidity from the Fed window, and in doing so make sure that the market works for everybody.

So if we believed today that we needed to expand the aperture of issuers that were eligible, that is something that we could certainly do, and we would be glad to work with you and your staff and other members of the Commission to identify underserved issuers that we might be able to expand the program to serve. But, again, the focus is on the number of issuers that are eligible as opposed to what we believe the importance of the program has been to make all issuers have access to capital at historically low rates.

Ms. Shalala. Dr. Zandi, the chief economist at Moody's, testifying in our second panel, is going to testify that State and local governments have already cut more than a million jobs as a result of the crisis. How does the

Federal Reserve reconcile its mandate to maximize employment with the very restrictive terms it established for the MLF, terms that severely limit its use by struggling State and local borrowers? That is just a follow-up question.

Mr. Hiteshew. Madam Chair--excuse me?

Ms. Shalala. Go ahead.

Mr. Hiteshew. I am sorry. Madam Chair, I would like to pass on that question and have that be addressed to our policymakers and the Chair. I am not here to talk about monetary policy. That is not my expertise. I joined the Fed in March with a strong background in the municipal markets and public policy relating to State and local government finance. So I would say that the Chair has advocated for more fiscal policy to deal with this crisis and that monetary policy tools are limited in their capacity to solve the problem.

I think all of us would agree that while State and local governments cannot cut their way out of this recession, neither can they borrow their way out of it. And if the legacy is operating deficit financing on State and local government balance sheets after this crisis is over, that will limit their ability to finance infrastructure, to educate our students, and to care for our elderly.

Ms. Shalala. Thank you. I yield back.

Senator Toomey?

Senator Toomey. Thank you very much, Madam Chairman. I just want to follow up on a point that Commissioner Ramamurti was making earlier, and I want to underscore the MLF is a primary market facility. In other words, its purpose is to purchase debt directly that is issued directly to the SPV that is set up under 13(3) for that purpose.

The corollary program for corporate lenders is the Primary Market Corporate Credit Facility, and that charges a penalty rate of 100 basis points above whatever the previously prevailing market rate was. And my understanding is there has been a grand total of zero issuance into the Primary Market Corporate Credit Facility.

Mr. Hiteshew, is it your understanding that there have been no direct issues into this corollary program, the Primary Market Corporate Credit Facility?

Mr. Hiteshew. You are correct, Senator.

Senator Toomey. So there has been no corporate subsidies going on here. I think there is an important point we need to keep in mind here. This program was never intended to be the mechanism by which we provide subsidized debt to municipalities. It is a fiscal question that that poses. Should the Federal Government be subsidizing any cost of a State or local government? It is a fair question. We can have that debate. But it is a fiscal debate, and that was not the purpose of these programs. But it was the purpose to ensure that municipal and State borrowers would have access to credit.

And so, Mr. Hiteshew, let me ask you this: Much has been made of the fact that there have been only two borrowers under this program. Are you aware of a significant number or any number--tell us what you know about States and municipalities that need access to credit and they cannot get it, they have no access to credit?

Mr. Hiteshew. Senator, I have a long history in the muni market. For better or for worse, a lot of people in the muni market know me, and they know how to get a hold of me. So I have had ongoing discussions with issuers and market participants since the first day on the job.

I can tell you that those first weeks, those first couple months, the phones were ringing off the hook to all members of the Fed.

Senator Toomey. Sure.

Mr. Hiteshew. There were extreme, extreme concerns out there, and that is why we rushed our facility to market so quickly.

Those calls have significantly cut back as issuers have had access to the market without the MLF, without needing to go to the MLF. They go directly to the market.

So I would not pretend to be the person who knows about every State and local government, the 50,000 issuers out there. But of those that are not directly eligible for the program, we are not aware of any, as I said in my testimony. But I am sure there are. There are some that have serious credit problems, especially if they are secured by, for example, a hotel tax, if they are a real estate transaction. There are credit problems out there. But we believe that the liquidity problems have been addressed.

Senator Toomey. So I think I heard you say you are not aware--you assume that they are out there somewhere, but you are not aware of a specific borrower or municipality or State that wants access to credit and simply cannot get it.

Mr. Hiteshew. Not from the MLF.

Senator Toomey. Okay. Some have suggested that the terms should extend much longer than the zero to 3 years. Let me ask you this: Is there distress, is there a lack of liquidity, is there a nonfunctioning market at the longer end of the maturity spectrum in the municipal market today?

Mr. Hiteshew. Well, there very much was in March and April and extending into May, and so that was a tradeoff that we had to make, as I said earlier. Do we rush to market something we knew we could make work and that would be large? The $500 billion was not necessarily designed to think that it will all be used, but it was meant to make a statement about the importance of the municipal market and that the Fed was entering that market for the first time in its history. And so by rushing to market a large program, open window, 3 years, which reflects generally what the maximum that State and local governments can borrow for liquidity purposes, we very much hoped and we have been pleased so far that it has translated into confidence at the long end of the market.

Senator Toomey. I understand that. But the short question is simply: Is there liquidity at the long end of the market today?

Mr. Hiteshew. There is.

Senator Toomey. Thank you.

Ms. Shalala. The gentleman yields back.

Commissioner Ramamurti.

Mr. Ramamurti. Thank you, Madam Chair.

Just quickly on Senator Toomey's point, first of all, the Secondary Market Corporate Credit Facility is subject to Section 13(3), just like this program, and is subject to the same penalty rate requirement, so I fail to see why accepting such a low rate on the secondary market program is okay for companies but we must demand a much higher rate when it comes to municipal borrowers. And, second of all, there is a primary market program for companies, the Main Street Facility, that has done quite a few loans. To date, it offers a 5-year repayment term, so it seems to me like without question that is an analog to the situation and a clear indication that the Fed could certainly extend the repayment term up to 5 years for municipal borrowers as well.

Turning to my next round of questions, the Fed recently issued a new statement on monetary policy. One of the main takeaways was that the Fed's legal goal of full employment is a "broad-based and inclusive goal." Fed Chair Powell also recently released a statement on racial injustice in which he said, "The Federal Reserve serves the entire Nation. Everyone deserves the opportunity to participate fully in our society and in our economy, and these principles guide us in all we do, including monetary policy."

Mr. Hiteshew, I assume you agree with those goals?

Mr. Hiteshew. Broadly. But, again, I am not here to address monetary policy. That is not my expertise, and so I would defer to your comments that the Chair made and would not have any further comment.

Mr. Ramamurti. Well, you do in a sense because the Fed lending programs, including the State and local government lending program that you run, are part of the Fed's exercise of its monetary policy power. It has been quite clear about that. So don't you think that the goals that I just described should guide how you design and implement the State and local government lending program?

Mr. Hiteshew. We are very concerned about the fiscal condition of State and local governments. As I said in my statement, 20 million workers, 13 percent of the workforce in the country, and there is--the recovery of the State and local market, State and local fiscal condition is critical to the overall recovery of the economy.

Mr. Ramamurti. Yeah, I appreciate that, and thank you for bringing up that point about the people who work for State and local governments, because if you look at that data, in my opinion, it is pretty clear that the Fed is failing to achieve the goals that Chair Powell and others have laid out.

The Fed's corporate credit facilities and other interventions have boosted the stock market, but black families do not share equally in that financial success. They make up more than 13 percent of the U.S. population but own only 1.5 percent of stocks.

Meanwhile, the Fed's failure to provide meaningful help to State and local governments is crushing black workers in particular. State and local governments have already cut more than a million jobs and are projected to cut 2 million more without Federal help, and they employ a disproportionate number of black workers. In fact, a worker who is laid off in the public sector is 20 percent more likely to be black than a worker who loses his or her job in the private sector. And I think that is part of the reason why the black unemployment rate currently is 5.7 percentage points higher than the white unemployment rate.

So when the Fed is stingy with State and local governments and generous with corporations and with Wall Street, it further widens the divide between black and white families in this country.

So, Mr. Hiteshew, if the Fed wants its recent statements to be more than just window dressing, don't you think it needs to do a lot more to account for these huge disparities in its COVID response so far?

Mr. Hiteshew. Commissioner, I think that we restored market access for the vast majority of State and local governments, and that translates directly into benefits in their community and preventing more cuts than have already happened. As I said in one my comments earlier, we agree with you that State and local governments cannot cut their way out of the steep decline in revenues and the rapid decline in revenues that we have seen, but neither can they likely borrow their way out of it. So--

Mr. Ramamurti. I appreciate, Mr. Hiteshew, and, again, I am sorry. My time is short. Look, I think you have to be realistic about the fact that if no further Federal aid is coming from the Federal Government directly, the tool that you have in front of you can offer significant relief to

State and local governments if you make the terms more generous while staying within the law.

And, look, I raised two issues in the first round of questions, which were lowering the interest rate and lengthening the loan term. It sounded like both of those were potentially consistent with the legal restrictions the Fed is operating under.

The other thing I am hoping that you can take a look at is something that the Chair mentioned, which is changing the eligibility requirements for the lending program. So, for example, Guam and Puerto Rico and Indian tribes are shut out categorically from this lending program. Other criteria like the credit ratings and also the fact that you have to be rated by a national statistical ratings organization are also exclusionary.

So will you just commit to me to take a fresh look at each of these eligibility restrictions through the lens of whether they serve what Chair Powell called "the Fed's guiding principles" of inclusion?

Mr. Hiteshew. Commissioner, we would be glad to do that.

Mr. Ramamurti. Thank you, Mr. Hiteshew.

I see my time is up, and I yield back. Thank you, Madam Chair.

Ms. Shalala. The gentleman yields back.

Mr. Hiteshew, let me thank you for your long service and for your time and testimony today.

We will now proceed to the second panel's testimony, and after all the witnesses have given their testimony--

Mr. Hill. Madam Chair?

Ms. Shalala. Oh, I am sorry. I am so sorry. My good friend Commissioner Hill, please.

Mr. Hill. Thank you, Madam Chair.

I want to follow up on this secondary market discussion that you had with Senator Toomey, and I wondered if you had evaluated the use of closed-in funds as a way to participate in the municipal secondary market. You noted that exchange-traded funds are fairly limited in municipals, but over the decades, closed-in funds, while not large cap, have been. Did you evaluate that as a potential way to support the secondary market?

Mr. Hiteshew. Thank you, Congressman. We have a team within the Fed that works with me on the municipal market and potential responses. I would not want to go into too much detail in terms of the types of interventions we have been evaluating, but suffice it to say that the secondary market intervention in the muni market would be complex. And, again, for the first time there are a number of considerations that we would have to be making. And so, again, we are evaluating the markets, and we are prepared to act if necessary. Closed-in funds and other ways of accessing or intervening into the secondary market have been evaluated, but I would not want to go further than that.

Mr. Hill. Okay, thank you. Let us talk about smaller States like Arkansas who received $1.25 billion of CARES Act money. They also in one of your modifications allowed Governors to designate the largest county or city to be an issuer, potential issuer to the MLF. Have you found that Governors taking you up on that offer have a majority of the States who were "small" and did not have a rated large municipality? Are they taking you up and designating counties?

Mr. Hiteshew. We have not received any indication of that. You would know better than me, Congressman, but we have not heard from the Arkansas Governor about Little Rock, for example.

Mr. Hill. I understand. I fully understand the situation in Arkansas. I just was curious more broadly because it illustrates, I think, Senator Toomey's point that we do not have a lot of Governors actually designating their larger cities or counties that are not previously designated as a large rated issuer.

I do want to talk about another challenge to smaller States, and that is the use of entities to issue debt, to participate in the MLF, and then support lower subdivisions in their State. In my home State, we have the Arkansas Development Finance Authority, ADFA, and it is the exclusive issuer of bonds for State agencies. And, therefore, they have typically acted as a conduit.

Is it the Fed's intention to let these sorts of conduit issuers have access to the program?

Mr. Hiteshew. Congressman, I am familiar with ADFA. I used to work with them a little bit when I was an investment banker. The program was designed initially to deal with State and local governments and their instrumentalities, generally essential service public providers. We broadened the definition, as you noted, to allow Governors to select up to two revenue bond issuers. The only limitation on the revenue bond issuer is that it has to be financing governmentally owned assets, so it is consistent with the State and local government--consistent with the MLF objectives. For example, ADFA probably issues a lot of private activity bonds. Those would not be eligible.

But to the extent that ADFA issues bonds for governmentally owned entities and they have a creditworthy revenue stream, they may be eligible for the program. We would be glad to talk to you about the specifics that you have in mind to determine whether, in fact, that entity would have direct access. I think it depends on what that entity is financing--

Mr. Hill. I understand. Well, I think that is a point of education in our States where you have a facility such as an arena that does not have business now due to the tourism impact and in some States government shutdowns. And, therefore, they are a public facility, sometimes operated by a county, sometimes operated by a facilities board, but they are not typically a bond issuer, and that is why I raise it. Is that something that you think might work under a conduit like an ADFA bond issuer?

Mr. Hiteshew. It may be able to. And, also, of course, the State or Little Rock, for example, could borrow on behalf of one of these arenas or entities pursuant to the downstreaming provisions of the original MLF design.

Mr. Hill. Right. Thank you for your testimony today. I appreciate your participation with our Commission, and I yield back, Madam Chair.

Ms. Shalala. Thank you very much, and I apologize, Commissioner. Let me thank Mr. Hiteshew for your time, for your service, and for your testimony today.

We will now proceed to the second panel's testimony. Let me submit for the record a letter from the treasurer-tax collector of Alameda County, Henry Levy. Without objection, for the record.

[The letter follows:]

/ COMMITTEE INSERT

Ms. Shalala. We will now hear from Mr. Patrick McCoy, director of finance of the Metropolitan Transportation Authority.

Mr. McCoy, you are recognized for 5 minutes.

STATEMENT OF PATRICK MCCOY, DIRECTOR OF FINANCE,
METROPOLITAN TRANSPORTATION AUTHORITY

Mr. McCoy. Thank you. Senator Toomey, Representative Hill, Representative Shalala, Commissioner Ramamurti, thank you for holding today's hearing examining the Municipal Liquidity Facility. My name is Pat McCoy, and I serve as the finance director of the Metropolitan Transportation Authority in New York. The MTA provides critical public transportation services to a population of 15 million people, including broad and diverse communities that have been most severely impacted by the COVID-19 pandemic. This region contributes nearly 10 percent of national GDP, and it is only possible because of the MTA.

Much like public service providers across the country, MTA is experiencing unprecedented financial hardship due to the pandemic. Prior to its initiation, the MTA was experiencing an $81 million surplus forecasted for our current year and 6 consecutive months of on-time performance. As a direct result of this pandemic, we have projected a $12 billion loss of revenue across 2020 and 2021.

Our core credit, the Transportation Revenue Bond, with nearly $30 billion outstanding, has been downgraded five times since March, and our long-term credit spreads have increased by over 200 basis points.

The impact continues to be felt, and we are desperately seeking $12 billion in Federal funding just to get us through 2021. Federal funding and financing opportunities through the MLF have been critical to the MTA thus far. However, financing tools are not a substitute for direct funding assistance and cannot solve the unprecedented fiscal crisis that we are facing.

As a frequent issuer with over $46 billion in bonds outstanding, market stability is crucial to the MTA. Between March 18th and 23rd, all U.S. markets experienced a precipitous decline in investor activity due to the pandemic. The $4 trillion municipal market seized up, resulting in short-end yields climbing to nearly 10 percent. With passage of the CARES Act and the MLF, credit markets, including the municipal market, were provided a critical boost in confidence that had a tangible positive impact on the free flow of capital.

To be clear, the MTA, as well as issuers across the country, would prefer funding to financing, especially when it comes to MTA's revenue shortfalls and other operating challenges brought on by the pandemic. The Federal Reserve should maintain this credit program until this crisis plays out. Many municipalities are likely to seek working capital solutions in the capital markets, which could place a significant strain on the municipal market in the near future.

The MTA was able to utilize the MLF in August with an issuance of $450 million of transportation revenue bond anticipation notes. Issuing the notes to the MLF provided a critical bridge to a long-term solution to address the repayment of this debt. Our competitive bid, as noted earlier, resulted in 20 bids from ten banks totaling $1.6 billion at varying rates. The average true interest cost of the bids necessary to clear the issue was 2.79 percent in comparison to the MLF cost at 1.93 percent. As a point of comparison, earlier in the year we issued $1.5 billion in bonds in early January with a true interest cost of 1.32 percent.

I would like to offer a few suggestions for the MLF that have the potential to help governments most in need and to provide issuers across the country the additional support to manage through the pandemic.

My first suggestion is regarding timing. Forecasts from economists broadly agree that the recession effects of necessary shutdowns due to the pandemic will have a lagging effect that will last well into 2021. An extension of the MLF's origination period into 2021 would very likely mean more access for issuers who will need it most.

The 36-month maximum term of the note is too restrictive. Few governments across the country utilize short-term borrowing due to constitutional or local policy-imposed restrictions. The MLF is really only relevant to a few large local governments across the country. If the facility was open to underwriting longer-term securities, a broader set of issuers could use the facility to finance infrastructure and finance COVID-related revenue losses.

Second, the Federal Reserve should reconsider the impact of penalty pricing to participate in the MLF. Provided the policy objective intended by Congress, we would encourage the Fed to refine its pricing structures in a way that would not unduly penalize an issuer.

Finally, access. This pandemic has different revenue and expenditure effects on different types of issuers, and it will continue to have a profound impact on the financial condition of governmental units that will continue to serve on the front lines of this national crisis. Expanding the facility to include an expansive network of essential public service providers will help to underpin the infrastructure we use to keep the country running.

I appreciate your consideration of this testimony. The MTA's consistent and overarching request from our Federal legislators is for direct, unencumbered funding to ensure stability in this environment where revenues are falling drastically short due to suppressed ridership. But our request also extends to support the municipal bond market.

We look forward to working with you to improve the Municipal Liquidity Facility.

Thank you.

[The prepared statement of Mr. McCoy follows:]

Ms. Shalala. Thank you, Mr. McCoy.

We will next turn to Mr. Marion Gee, the president of the Government Finance Officers Association and the finance director of the Metropolitan St. Louis Sewer District.

Mr. Gee, you are recognized for 5 minutes.

STATEMENT OF MARION GEE, PRESIDENT, GOVERNMENT FINANCE OFFICERS ASSOCIATION, AND FINANCE DIRECTOR, METROPOLITAN ST. LOUIS SEWER DISTRICT

Mr. Gee. Thank you. Senator Toomey, Representative Shalala, Representative Hill, and Commissioner Ramamurti, thank you for holding today's hearing on the Municipal Liquidity Facility created under the CARES Act. I am Marion Gee, and I am honored to be here in my capacity as president of the Government Finance Officers Association. But I will also share some insight with respect to the Metropolitan St. Louis Sewer District where I serve as finance director.

The CARES Act was an important start to provide some relief to State and local governments as we attempted to navigate the response to the COVID-19 pandemic. The response continues and further assistance is needed. The first best option is to provide direct Federal funding as it can be rapidly deployed; whereas, borrowing is inherently most costly and time-consuming. Since additional funding is not a guarantee, the Federal Government must explore other ways to help State and local governments as we navigate these challenging times.

Today I will focus on the MLF, specifically why local governments and State governments are not using that, and recommendations to enhance its effectiveness to public sector entities.

Not all public entities providing vital services are the same, and each face unique challenges that require practical solutions to help us face those challenges. As currently designed, the MLF is too costly of a solution for us, nor is access widely granted. We all need clean, safe water to take the important step of washing hands and for other hygienic purpose to protect the public health.

The National Association of Clean Water Agencies projects the total impact to clean water utilities nationwide from lost commercial and industrial revenues at $12.5 billion over the year and $3.8 billion of revenue losses from increased household bill delinquencies due to the COVID-19-related job losses.

Commercial water usage on which my agency bases a portion of its bills is projected to decrease by roughly 17 percent over the current fiscal year. We will face additional challenges as water usage relating to residential customers is increasing. The revenue losses and substantial costs for maintaining services pose a significant challenge for public entities like mine.

Next, my State and local government colleagues face similar revenue struggles and will continue to do so into 2021. Since more direct funding is uncertain, we need additional options from our Federal partners at a low cost and recognize the uncertainty regarding how long this public health crisis will last.

Income, property, and sales taxes are among the main sources of revenue for State and local governments. Since revenues generally lag behind economic changes, the full picture of the pandemic's impact on these will be unknown for some time.

This leads me to the MLF. As currently designed, it is not a practical solution for many public entities. Direct access to the MLF is too restrictive for most public entities. Only 250 entities are eligible to directly access the facility, leaving out the vast majority of nearly 80,000 public issuers. My agency is not an eligible entity to directly access the MLF unless it is designated as an eligible revenue bond issuer by the Governor.

Access should be expanded to a larger, more diverse pool of issuers. The MLF's 36-month term should be lengthened, and borrowers should have greater flexibility with regards to the use of the proceeds. The vast majority of public entities issue debt for capital needs more than they do for operational needs. Issuing 36-month debt is rare. Increasing flexibility so borrowers can use proceeds for investments like capital projects means job creation and boosting the economy.

The Fed should extend the underwriting deadline of the MLF beyond December 31, 2020. The facility is currently set to expire at the end of the year, even though we will not know the extent of revenue challenges State and local governments will face until well into 2021.

The MLF pricing is unduly punitive. The penalty pricing structure of the MLF term sheets does not make it a viable solution for municipal issuers like my agency. Pricing should be competitive with the market or lower; issuers in dire circumstances should not be penalized. The Fed should create a facility to provide relief by purchasing municipal securities in the secondary market, similar to the secondary purchasing program in the Secondary Market Corporate Credit Facility. Given the uncertainty regarding the duration of the COVID-19 pandemic, we could see a replay of this year's cash crunch and selloff in the muni market.

Thank you for the opportunity to address the Commission today. I am happy to address any questions.

[The prepared statement of Mr. Gee follows:]

Ms. Shalala. Thank you, Mr. Gee.

We will next turn to Mr. Chris Edwards, director of tax policy studies at the Cato Institute.

Mr. Edwards, you are recognized for 5 minutes.

STATEMENT OF CHRIS EDWARDS, DIRECTOR, TAX POLICY STUDIES, CATO INSTITUTE

Mr. Edwards. Thank you very much for inviting me to testify today. I will discuss the Municipal Liquidity Facility and State budget challenges. I have two general points.

First, with the economy rebounding, State revenues likely will not fall as much as originally projected. Further aid from the Fed or Congress is not needed, in my view.

Second, the MLF undermines market discipline on State borrowing and risks politicizing the Fed.

Regarding the State budget situation, Bureau of Economic Analysis data for the second quarter of 2020 show that total State and local tax revenues dipped just 3 percent from the first quarter. Sales and income tax revenues fell, but property tax revenues increased slightly. Home prices in July were up 5 percent over last year, and if they stay up, that will help boost city and county budgets in the months ahead.

During the recession a decade ago, local tax revenues did not fall, and that is because property tax revenues remained stable.

Looking at the BEA data from the first to the second quarters, total State and local tax revenues fell $13 billion, but total Federal aid to the States soared $193 billion. That suggests to me that the States generally are not short of cash, although some places like New York City do face big challenges.

A recent NCSL survey of 37 States found that tax revenues are expected to be down 10 percent on average in 2021 compared to original projections. That translates into just a 4-percent tax revenue drop from the 2019 peak. Most States can handle a downturn with the rainy day funds and spending restraint going ahead. It is true that the States differ. New Jersey and Illinois saved zero in their rainy day funds, even after 11 years of economic expansion. That was totally irresponsible, in my view. If Illinois had saved in its rainy day fund, it would not have needed the MLF loan. And, again, if Illinois had been more responsible and saved in its rainy day fund, it would not have needed the Federal Reserve loan.

Here are some concerns about the MLF. Finance expert Robert Pozen warned in an op-ed that expanding the MLF could politicized the Fed. I mean, imagine if the Fed began making regular loans to the States. All those swarms of lobbyists that currently surround Capitol Hill today would open offices surrounding the Fed's headquarters on Constitution Avenue in Washington. That really would not be a good outcome.

In general, State and local governments are far more fiscally responsible than the Federal Government, and not just because they have balanced budget requirements but also because of the discipline of credit markets. State and local governments have strong incentives to act with fiscal prudence to boost their credit ratings and lower their borrowing costs.

Federal Reserve intervention into State and local finance undercuts incentives for fiscal responsibility. It makes no sense for the central bank to undermine market interest rates, which properly reflect market risks and credit risks, in order to reward fiscally unsound jurisdictions.

The first MLF loan went to Illinois, which has probably the worst-run finances in the Nation. Did the MLF Loans stave off a liquidity crisis in Illinois? Not at all. The MLF loan allowed Illinois to increase its 2021 general fund budget by 5.9 percent, including $250 million in salary increases for State workers. So the MLF loan discouraged needed restraint in Illinois, in my view.

In the long run, congressional and Fed subsidies undermine incentives for State and local policymakers to build rainy day funds, to reduce their debt loads, and to pursue restraint.

So, in closing, what about the economy in general?

Some analysts support more Federal aid and Fed loans to the States, believing it creates a large multiplier boost to the economy. I cite evidence in my written testimony that those multipliers may not be large. While government spending may boost GDP in the short run, a negative side effect is crowding out or shrinking the private sector, which undermines long-term growth. In the long run, growth comes from innovation in the private sector, and if you crowd out the private sector, you are going to reduce innovation and growth in the long run.

More deficit spending also means higher taxes down the road, and with the economy now recovering, it is not prudent or fair, in my view, to burden younger Americans with even more government debt.

In sum, the MLF undermines the healthy discipline of the municipal bond market and the discipline it creates for State and local governments. Going forward, the States should build larger rainy day funds so when the next recession hits, they will be much better prepared.

Thank you very much.

[The prepared statement of Mr. Edwards follows:]

Ms. Shalala. Thank you, Mr. Edwards.

We will next turn to Dr. Mark Zandi, chief economist at Moody's Analytics.

Dr. Zandi, you are recognized for 5 minutes.

Dr. Zandi, are you on mute?

Mr. Zandi. Sorry about that. I apologize.

Ms. Shalala. We do it all the time.

Mr. Zandi. I do as well. I apologize.

STATEMENT OF MARK ZANDI, PH.D., CHIEF ECONOMIST, MOODY'S ANALYTICS

Mr. Zandi. To start over, I just want to thank the Commission for the opportunity to speak and participate today. And I also would like to say that my comments are my own and do not represent those of the Moody's Corporation.

I do have a few charts I would like to show. We will see if we can do that along the way. I will reference them as we go. I will make three points.

First, the finances of State and local governments have been hit hard by the crisis. At Moody's Analytics we estimate that State and local governments in their totality will suffer budget shortfalls of somewhere between $450 billion and $650 billion through fiscal year 2022 depending on the ongoing pandemic. This is a shortfall relative to a flat budget baseline that just assumes that States have enough funding to keep the lights on and avoid layoffs. They do not include any real discretionary budget increases or address any long-term structural problems such as pension or post-employment benefits, and they assume that all of the rainy day funds that the States have are used.

States suffering the biggest expected budget shortfalls are shown in red and orange in the first chart, so if you can see that. States dependent on their oil and natural gas industries, including Alaska, Louisiana, North Dakota, and

West Virginia, will suffer among the most serious budget shortfalls since energy prices have collapsed in the crisis. And States hit hard by the virus, such as Connecticut, New York, New Jersey, and those with large tourist industries, such as Florida and Hawaii, will also suffer outsize budget shortfalls.

Some suggest that State and local governments were profligate spenders prior to the pandemic and should not be supported. There is no evidence of that. As you can see in this second chart, as a share of GDP, State and local government spending pre-pandemic was consistent with their spending during the past 30 years. Most have done an admirable job of raising rainy day funds prior to the pandemic. If you add it all up, it was close to 10 percent of total State government revenue. Only a handful of States--Illinois, Kansas, and Pennsylvania--did not sock something away.

The second point I would like to make is that, without additional fiscal support from the Federal Government, State and local governments will have no choice but to cut back on payrolls, essential government services, and critical programs, and this will severely impact Americans in nearly every community and exacerbate the Nation's serious economic problems. We estimate at Moody's Analytics that failure by lawmakers to provide any additional direct aid to State and local governments will threaten the recovery. The odds of recession, return to recession is high. It will cut as much as 3 percentage points from real GDP and erase almost 3 million jobs over the next 2 years. This is on top of the little over 1 million jobs State and local governments have cut in the past 6 months in response to the crisis. That is equal to 6 percent of all jobs. And you can see that in the third chart that I would like to show.

These jobs include obviously very critical jobs, police officers, firefighters, health care workers, emergency responders, social service providers, teachers. These are folks that are critical at any point in time, but particularly in a pandemic.

Finally, my third point is that since it is increasingly unlikely that Congress and the administration will come to terms on more aid to State and local government, at least anytime soon, the Federal Reserve's 13(3) Municipal Liquidity Facility should be made more generous to facilitate its use by hard-pressed State and local governments. To this end, I would make a few recommendations, some of which you have already heard. I would extend the facility's expiration date beyond the end of this year. I would lower borrowing costs to make them less punitive. I would lengthen terms to make this more operational. I would allow for a deferred payment structure such as that provided in the Main Street Lending Facility for mid-sized companies. And, finally, I would permit MLF funds to be used more broadly than it is currently.

Policymakers deserve a lot of credit for responding aggressively to the pandemic. They have used the Federal Government's resources to help bridge American households and businesses to the other side of the pandemic. The Federal Government's financial support has run out, but the pandemic rages on. The bridge is unfinished. Unless lawmakers act quickly to extend it, many lower-income households and small businesses in particular face financial devastation. Congress and the administration should agree to another significant fiscal rescue package that includes substantial direct aid to State and local governments, and the Federal Reserve should become more expansive in its implementation of the Municipal Liquidity Facility.

Thank you.

[The prepared statement of Mr. Zandi follows:]

Ms. Shalala. Thank you. Thank you, Dr. Zandi, and the other witnesses as well for their testimonies.

As with the first panel, we will move to two rounds of 5-minute questioning of these witnesses. I will recognize myself for 5 minutes of questions.

Dr. Zandi, let me start with you. Mr. Edwards, a fellow economist, testified that the States are facing budget challenges, but they can restrain spending, tap rainy day funds to balance their budgets without further aid from Washington. He also said that millions of American businesses have tightened their belts in recent months, so why can't governments?

In your expert opinion, can State and local governments simply tighten their belts in lieu of additional Federal assistance? What would be the economic and social consequences of such a proposal?

Mr. Zandi. I think the fiscal pressures here are incredibly intense, and I mentioned $450 billion to $650 billion through fiscal year 2022, so over the next 2 years, and that assumes that they use all of the rainy day funds that were quite ample coming into this. And if there is no additional support, then State and local governments will be put into a position of significantly cutting back. That means payrolls, more job loss, as I mentioned, 2 to 3 million more in job loss, and that is going to happen relatively soon, relatively quickly, if they do not get the aid. That means cutbacks in essential government services. You know, the key programs, many of those programs are critical to supporting the most hard-pressed in our communities--lower-income households, smaller businesses. And this would be devastating to the economy, very procyclical, exacerbating the end downturn.

I should point out, you know, providing aid to State and local government in recessions is tried and true. We do this every single time we face this because we know that if the Federal Government does not provide help to State and local governments, they will have to make those cuts. That will exacerbate the recession and make things worse for everyone and for the broader fiscal situation. So this is something that we have done in each recession. We did it in the financial crisis. There is lots of good academic research that shows that. And not doing it here would be a significant error.

Ms. Shalala. Thank you.

Mr. McCoy, Mr. Edwards testified that the two MLF loans have saved the issuing entities interest costs, but that is not a goal worth undermining federalism for and pushing aside the market interest rates. You represent one of the issuers that borrowed under the MLF. How do you respond to that testimony? What would be the impact to the MTA and your city's residents if the Federal Reserve provided no aid either through the MLF or otherwise?

Mr. McCoy. Thank you for the question. You know, I believe that without the MLF, we would incur higher costs. We know that, and I included that in my testimony. The facility has both practical applicability as well as psychological applicability to the entire market, and that has clearly had a very calming influence on the market, and the availability of this facility for State and local issuers cannot be underscored enough. To not have it, I think we would see a very different environment in the municipal market today, much more challenging conditions for issuers to get in and borrow money at rates that, you know, would have been common pre-COVID.

I hope that answers your question.

Ms. Shalala. Thank you.

Mr. Edwards, your fellow panelists all warn of devastating job cuts, service cuts, and slow economic rebound across the country if additional Federal aid is not provided. My city, Miami, had a surplus and a rainy day fund, yet we are also facing devastating cuts. Despite overwhelming testimony to the contrary, you state that there is no national crisis in local government finances. Could you please explain why you believe that to be the case?

Mr. Edwards. Thanks for the question. So I agree with

Dr. Zandi that, you know, some States and some jurisdictions are in trouble. Some energy-producing States like Wyoming and Oklahoma, they have seen a drop in revenues in some cities like New York City, they are in trouble, Hawaii is in trouble because, you know, they depend on tourism, of course.

But, generally, if you look back at the recession 10 years ago, local governments actually did not lose revenues overall, and that is because property tax revenues are very stable. And it looks again like during this recession--if things do not get worse; they seem to be getting better--that local governments in general what we find, because property tax revenues will stay strong.

I would also say that, you know, there is continuing to be some money in the pipeline from aid that Congress has already passed. I noticed a news story a couple days ago the legislature of North Carolina just now appropriated $1 billion from the CARES Act, which was passed 6 months ago. North Carolina is just getting around to actually appropriating the money now, the $1 billion.

I also noticed another news story a couple weeks ago that Idaho used $200 million from the CARES Act to cut property taxes in the State.

So, you know, yes, some jurisdictions are in trouble, but there are plenty of other jurisdictions, and I think most jurisdictions, that are going to do fine, frankly, without further aid.

Ms. Shalala. Thank you. I could not disagree more. I think much of that money was obligated.

Let me yield and turn to Senator Toomey for 5 or 6 minutes of questioning. We seem to be going on.

Senator Toomey. Thank you.

Ms. Shalala. Whatever you need.

Senator Toomey. Thank you, Madam Chair.

Let me follow up on this. According to multiple published news reports, last month the Governor of New Jersey proposed a $40 billion budget that is $1.3 billion more than the budget from last year. This summer, the State of Connecticut gave its unionized State workers a 5.5-percent raise. In July, Illinois gave hundreds of millions of dollars worth of pay raises to its workers. Some States, like New York, have delayed a scheduled pay increase, but they have not canceled it because they are expecting a Federal bailout.

Mr. Edwards, does that kind of behavior suggest to you dire circumstances that can only be met with additional Federal money?

Mr. Edwards. I agree with your point there. There are a lot of States here that are--you know, they are not doing what they can to restrain spending in this recession. As I pointed out, Illinois just passed a budget where the general fund was increased over 5 percent. If Illinois had built up a rainy day fund, say, of 10 percent of their spending, that would have been around $4 or $5 billion. That would have easily covered their short-term cash flow problem. And I actually do not think there was a cash flow problem in Illinois. It is just that they were able to borrow at a lower Federal rate.

I think that, you know, during a recession, I think State and local governments are learning valuable lessons here. They have to plan ahead. They should lower their debt load in anticipation that we will have another recession down the road, and they should build a bigger rainy day fund.

So, you know, State and local governments are not subdivisions of the Federal Government. They have enormous fiscal powers by themselves. And I do not think they ought to be running to Washington whenever they get into fiscal trouble. I think they can solve their own problems.

Senator Toomey. So let me look at it from another perspective. Mr. Zandi in his testimony, written and oral, tells us that the total projected shortfalls through fiscal year 2022 are between $450 billion and $650 billion if there is a serious second wave of the virus. Now, we had a little bit of a second wave in some States over the summer. That clearly has abated. And economic numbers are coming in much stronger than were projected by just about anyone in recent months.

So according to Mr. Zandi, the budget shortfall estimate through 2022 is $450 billion, maybe higher. But how much money have we already sent to State and local governments?

I would like to submit for the record a page from the Committee for a Responsible Federal budget, Moody's Analytics, September 16, 2020, coronavirus funding for State and local governments, and it gives a breakdown that adds up to $456 billion. That is how much we have already sent to State and local governments, and the projected shortfall by Mr. Zandi and Moody's Analytics is for a shortfall of $450 billion or up to $650 billion if there is a serious second wave.

So, Mr. Edwards, first of all, I do not know if you have drilled down into these numbers, but as you point out, there are many municipalities where property taxes are coming in at or above last year. Do you agree with this range of likely shortfalls? And is there a reasonable likelihood that we have already sent as much money to the State and local governments as their entire shortfall is likely to be?

Mr. Edwards. Well, first, you know, with respect to

Dr. Zandi's projections, no one knows the future. Perhaps he is right about the size of those shortfalls; perhaps they are lower, as I think. I would say there is a measurement issue here. Again, if you look at the National Conference of State Legislatures' survey of 37 States from a couple weeks ago, they show that tax revenues will be down 10 percent next year from projected increases. But projected increases were around 6 percent, so that really translates into about a 4-percent revenue loss from the 2019 peak. I do not think that is a crisis level of reductions. I think State and local governments ought to be able to handle those sorts of revenue shortfalls.

So, again, I think, you know, local governments could come through this pretty well because it does look like property tax revenues will stay up. It is true that in some central business districts the office commercial real estate will fall, but industrial property prices are staying high as well. So, you know, I think local property tax revenues will be fine, and I think States are going to be able to handle the modest State tax reductions.

A last point on that, actually. You know, the new CBO Federal projections came out a couple weeks ago, and they have got Federal revenue falling--total overall Federal tax revenues falling 5 percent in 2020, 1 percent in 2021; then they are going to start booming again and rise 15 percent in

2022. So the CBO does not think that Federal revenues are really going to fall all that far now, and usually State and local tax revenues do not fall as far as Federal revenues because the Federal tax system is more progressive. So I think State and local governments will be fine. I am hoping they will be fine. But, you know, I could be wrong. We do not know the future.

Senator Toomey. Thank you.

Thank you, Madam Chairman.

Ms. Shalala. Thank you.

Commissioner Ramamurti.

Mr. Ramamurti. Thank you, Madam Chair.

Just quickly on the point about a second wave, and, look, we have plateaued in a situation where 1,000 Americans are dying every day, and we are about to enter winter flu season, and we have seen in other countries already a resurgence of the virus. So I think the idea that we have put a possibility of a second wave behind us is not correct.

But, look, even though we are 6 months into this crisis and State and local governments are in rough shape, as we have heard from the issuers today, the Fed's lending program has made only two loans to date. So, Mr. Gee, you represent State and local government financing officers across the country. Do you think the Fed's State and local lending program has had so little uptake because State and local governments already have all the resources that they need?

Mr. Gee. No, sir, I do not. I believe that the reason that you do not see usage centers around the way that the program is structured. As I mentioned earlier during my remarks, the 3-year term is restrictive, as is how the proceeds can be used. State and local governments are basically penalized if they use that liquidity facility, which is why I think you will not see issuers take advantage of it.

Mr. Ramamurti. Thanks. And, look, we have talked about it in the abstract, but I just want--you are on the ground, so I want to get your sense of what are the concrete impacts of this budget crunch. If State and local governments do not get additional help, either directly through the Federal Government or through this lending program, what are the consequences of that? And who is bearing the brunt of those changes?

Mr. Gee. Citizens are bearing the brunt if no action is taken. What we are seeing is crucial services being cut, things like homeless prevention services, public health-related services. So we are not out of the woods yet. I think that some may have too rosy of a viewpoint that things are turning around. Quite frankly, that is not what I am seeing or hearing from my colleagues throughout the country.

Mr. Ramamurti. Thank you. And, look, there has been plenty of data talking about this idea of a K-shaped recession where people who were already well off coming into the crisis are doing okay, but people with lower incomes are really suffering. And, of course, the cuts to State and local government that you are talking about also tend to fall disproportionately on those folks who are already suffering.

So let us talk about how to make this program more useful within the legal restrictions that Congress has created. Mr. Gee, your testimony asks for the Fed to set their rates as low as possible within the law. Mark Zandi, who just testified, said that the rate could go as low as just slightly above the Federal funds rate, which, in other words, is pretty close to zero. How low of a rate would you support?

Mr. Gee. I would support anything that is at a market level or more than a market level. You are not going to get participation in the program if the rates are punitive.

Mr. Ramamurti. Thank you.

Mr. Gee. And they currently are.

Mr. Ramamurti. Thanks. And, Mr. McCoy, I want to bring you in here because your testimony noted that even though you ended up using the Fed's lending program, the MTA paid an interest rate of 1.9 percent, which was actually quite a bit higher than the 1.3 percent that you paid just before the pandemic hit for a similar type of note. So, by contrast, the Fed's interventions have already allowed big corporations to actually pay less to borrow now than what they were typically paying pre-pandemic.

So let us say that the Fed did the same thing for you that it has done for big corporations. Say that they provided a rate of about 1.3 percent instead of 1.9 percent. How much would that end up saving the MTA over the life of the loan?

Mr. McCoy. Sure. Thank you for the question, Commissioner. So the rate that we received through our MLF issuance saved the MTA $8.235 million over the 3-year maturity. Just to give you more granular detail, a one-basis-point change in the rate is equivalent to $135,000 on that $450 million loan. So it clearly saved us money, and that was a good thing. But, again, you know, I come back to the other part of my testimony where we talked about the revenue loss that we are experiencing. One of the other witnesses talked about, you know, property taxes not being impacted so severely by COVID. Well, here at the MTA we do not receive property taxes. We are not a taxing entity. We rely on fare box revenues, and we have the highest fare box recovery ratio of any public transportation provider in the country. That means when our ridership dropped down by 95 percent due to COVID, our revenue hit was immediate and severe. And we are continuing to forecast severe impacts from reduced ridership well into 2023. So--

Mr. Ramamurti. Thanks, Mr. McCoy. I hear the Chair hitting the gavel. Just to do the math quickly on that point, if you had gotten a rate similar to what you had gotten pre-pandemic of 1.3 percent, doing the math, that looks like that is about a $4 million savings, which I imagine would allow you to keep some people on payroll. It would allow you to potentially offer more transit services or lower-cost services. That money makes a real difference.

And so, look, I keep coming back--

Mr. McCoy. Correct.

Mr. Ramamurti. --to this point. If we are able--if the Fed is able to offer State and local governments just the same type of deal that it is offering corporations right now, it can make an enormous difference in people's lives. It can make a difference in the lives of children and people with disabilities and seniors and others who are often more dependent on services that the State and local governments provide. That is really what is at stake here.

Thank you, Madam Chair.

Ms. Shalala. Thank you.

Congressman Hill, I owe you as much time as you would like.

Mr. Hill. Thank you, Madam Chair. You owe me nothing, just your friendship.

I thank our panelists again for being here. Very interesting testimony. Very informative.

I want to begin my questions in this round to talk about this difference that both Mark Zandi referenced and Mr. Edwards on the uneven nature of the economy reopening and the uneven burden around the States, and recognize our States have lots of authorities to control their own destiny, which we have heard about.

I have a slide, if I could put that up for our viewing audience and my fellow Commissioners. I looked at tax revenues for different States, and in this instance I decided to look at it based on the impact of the virus. So you can see Arkansas, Texas, New York, and California. These are States that are not normally compared to one another, but I am using approximately 2,000 cases per 100,000 infection rates. But in the case of Arkansas and Texas, those Governors basically kept their States open in fighting the coronavirus, trying to minimize the impact on dislocation of their economies. And you can see that tax revenues July year over year are up 14.9 percent in Arkansas, 4.3 percent in Texas. And our friends in New York who bore a huge brunt at the beginning of this terrible pandemic, tax revenues year over year in July are down almost 9 percent and in California down 45 percent.

I would like to insert that in the record, Madam Chair. Thank you.

[The slide follows:]

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Mr. Hill. Also, Mr. Zandi I think made a very important point about economic concentrations so that if you are heavily in tourism, like Hawaii or my friend from Florida, or in the oil and gas business as noted in his statistics on North Dakota or Oklahoma, you have also additional burdens, not necessarily per se connected to the pandemic, but we have a major dislocation in the oil and gas market partially as a result of the economic shutdown around the world and supply conditions.

When you look at June 30th, of the 46 States that end their fiscal year in June, 8 States actually had overall tax growth when including personal income, corporate income, and sales tax income. And I also want to highlight that, in addition to the Municipal Liquidity Facility, as Senator Toomey has noted, we have distributed billions of dollars out to our States directly and indirectly. And when you look at both direct and indirect, it is about $700 billion are distributed to the States.

To that end, Mr. Edwards, let us talk again about your way States can cover their budget shortfalls. I think in your testimony you said that about people--or States had built up their rainy day funds to about 13 percent of a typical annual revenue budget. Is that right?

Mr. Edwards. It is a bit less. I think it is about 9 percent going into this, although there is a measure called "total balances" which are essentially all the extra cash that States have kicking around. That is higher, maybe up around 12 percent.

Mr. Hill. And you also noted that you felt many of the States could access the market quite successfully. I was looking at all of our States' bond ratings before this hearing, and 90 percent of our States are rated double A or better. Wouldn't they have regular access to the capital markets?

Mr. Hill. That is absolutely right, and, in fact, all States would have better access at lower interest costs if they reduced their debt burdens during economic growth years. So, you know, the MTA, for example--I sympathize with the plight of the MTA in New York. It is in terrible trouble. But they would be in a lot better position if New York area policymakers had not let the MTA get so deeply in debt. It is deeply in debt. The interest costs as a share of its cash flow have risen pretty dramatically.

States can avoid getting into that position. Some States finance a lot of their capital investment pay as you go. Most roads and highways in the United States are financed mainly pay as you go, meaning gas tax revenues. So if you look at some States, like Nebraska, they have very low debt loads. That really bodes well for those sorts of States. When you go into a recession, they are in a much better financial position, it seems to me.

Mr. Hill. Thank you. I will also note for the record, Madam Chair, that Illinois, of course, we have talked about here, has accessed the market successfully and participated in the Municipal Liquidity Facility. It is the lowest rating of the States I reviewed at BBB. New Jersey, which was just reported to us this morning, is entering the market and has an expanded budget, is single A minus; Kentucky and Connecticut at single A; and Senator Toomey's home State of Pennsylvania at A-plus. So essentially all of our States, the 90 percent of States that are double A or better or these States that even have slightly lower rating--modestly slightly, I might add--have all accessed the market quite successfully.

Thank you, Madam Chair. I yield back.

Ms. Shalala. Thank you, Congressman Hill.

We will repeat our order of questioning, and each Commissioner will now have a second round of questions for these witnesses. I will start by recognizing myself for 5 minutes.

Dr. Zandi, according to Mr. Edwards' testimony, economic conditions in the municipal bond market are normalizing. I represent Miami. He clearly missed my community. And he also said it is not fair or prudent to increase government borrowing and spending further. Among other things, he cites projected versus actual State and local revenues.

Do you agree with his assessment of the economic outlook and his statement that additional Federal assistance is not fair or prudent? And could you repeat your recommendations with regard to the Municipal Liquidity Facility and additional Federal assistance or otherwise?

Mr. Zandi. Sure. Well, thank you. No, I think the budget situation is very serious, and it is a script being written, that there is a lag. We are already seeing a lot of the revenues get pummeled here, but there is a very significant lag between what is going on in the economy and when it shows up in tax revenue, you know, particularly like income tax revenue. A lot of what we are observing now is based on final settlement payments in 2019 income when the unemployment was 3.5 percent and wage growth was strong. It does not reflect what is happening in 2020.

So I think as we get more numbers towards the end of this year going into next year, we are going to see significant declines in income tax revenue in more and more States across the country. This is an ecumenical problem regionally. It is not just, you know, a few States. It is going to be--much of the country is going to be involved in this.

Property tax revenue the same way. That is a long lag.

You know, the problem this go-around is that house prices as much--that was the problem in the financial crisis. This go-around it is going to be commercial real estate values, and it is going to take awhile for that to flow through and it is going to have a big impact on revenues for lots of local governments across the country.

And I think it is clearly evident--I mean, we can pick anecdotes across the country, but for me, the thing that encapsulates the stress most vividly and clearly is that State and local governments in the last 6 months have reduced payrolls by 1.1 million jobs, 6 percent of their workforce. And I think in the last couple three months they have delayed those cuts because they hoped and they believed--because most everyone believed--that they would get some additional Federal Government aid to help support them. And now as it becomes increasingly clear that that aid is not coming through, they are not going to get that aid, I think these cuts are going to become quite significant.

So we are going to see how things go here pretty quickly, I think, over the next few months, certainly by the end of the year, how serious this is and how much economic damage it is going to cause to communities across the country.

Finally, I would say that $450 billion low-end estimate of the budget shortfall through fiscal year 2022 is on top of the Federal Government support that has already been provided. So in those calculations, that is history; that is in the data. It is $450 billion on top of that, assuming no significant increase in infections going forward, so very significant.

So in that context, what I just described to you, that outlook, I think it is critical that we look for other tools to try to support State and local government in the Municipal Liquidity Facility. Here is what I would do. The first thing I would do is extend it, because, you know, this is a script being written. The pandemic is not going to be over on December 31, 2020. We have got to extend it.

Secondly, we have got to lower the rate. The Fed is willing to do this. They lowered it once. I think they need to lower it again, make this less punitive so it opens up access.

Three, extend the term. You have already heard from the other folks that are on the ground here that 36 months is just not practical. That means it is not particularly useful.

Fourth, I would really think about expanding out what the money can be used for.

And, five, you know, think about how you can defer some of these payments to make it a little bit more attractive.

Here is the thing: I could be wrong. Actually, I hope I am wrong. You know, hopefully the world, our economy, the fiscal situation turns out a lot better than I am anticipating. But, look, I fear that I am right; and if I am right and we are not prepared for it--if we do not prepare for it--you know, Policymaking Economic 101. When you have a lot of uncertainty, you press on the accelerator. You do more than you think is necessary because you do not know. And I assure you we do not know. This pandemic is still ongoing.

Ms. Shalala. Thank you.

Senator Toomey.

Senator Toomey. Thanks, Madam Chair.

Mr. Gee, we took a look at where the St. Louis Sewer District debt is trading in the secondary markets, and according to our sources here, it looks like they are trading at the lowest yields in at least 5 years. Paper with 3 years' remaining life is trading at 21 basis points. And you suggested that the MLF should be offering rates below what the market is offering. But, obviously, this whole program is ultimately backstopped by U.S. taxpayers.

How much lower than 21 basis points should taxpayers be lending money to the St. Louis Sewer District when it can borrow money for 21 basis points in the capital markets?

Mr. Gee. Well, sir, I am not suggesting that taxpayers lend money specifically to my agency. I was speaking in terms of State and local governments, which may not be in as good financial shape as our agency. We are a triple A rated utility, so the conditions that we are currently facing may not be as dire for us as they are for some of my colleagues at the State and local governments. But I think what we are asking for is to simply make the MLF competitive. And as it exists right now, it is not competitive. So if you are actually looking for entities to utilize this facility, then I believe that the rate structure needs to be at market rates or lower.

Senator Toomey. I cannot disagree with the notion that if the goal is to get people to borrow, you have to give them a better deal than what they can get in the capital markets generally. That is just not my goal. My goal was always to ensure that we would have a liquid functioning market, and we have that.

Mr. Edwards, two questions. The first is we have never had an MLF before, but we have had recessions before. We have had all kinds of disasters before. How have States and municipalities managed through difficult times in the past? That is one question.

Then the second is we have got a very wide range among our States and certainly among municipalities in terms of expenses per capita, in terms of tax regimes and tax revenue per capita. And the people of the various States get to decide through the elections they held what kind of regime they want.

If the Federal Government is going to be a sort of permanent backstop, bailout mechanism, how does that change the mechanism of accountability in State government?

Mr. Edwards. That is a great question, and one of the things I am really concerned about here is the incentives for State and local governments going forward. The more the Federal Government gets involved in this sort of emergency loan to State and local governments, the less incentive they have to be prepared for the future. As Dr. Zandi noted, most States did build up substantial rainy day funds after the last recession. California, for example, was really hard hit during the recession a decade ago, and to their great credit, they built up a very large rainy day fund. So that is great. So you have to think about forward-looking incentives here.

To go back to some of the previous discussion, people have compared the Federal Reserve's mechanisms for businesses and governments. But there is a basic difference here in that governments can always raise tax revenue. They have fiscal power. They can always issue debt, and they can always trim spending. Businesses during recessions, especially when State and local governments are mandating closures of millions of small businesses, they often do not have a choice. They get into terrible fiscal and financial trouble because the revenues just disappear in front of their eyes. Governments are really never in that situation because they can always rely on taxation. And for local entities like the MTA, I think the first backstop ought to be State-level governments and not the Federal Government. I think State-level governments have enormous fiscal power, and if their local governments get into trouble, I think that should be mainly their responsibility.

Senator Toomey. Thank you.

Madam Chair, I yield back my time.

Ms. Shalala. Thank you.

Commissioner Ramamurti.

Mr. Ramamurti. Thank you, Madam Chair.

Mr. Edwards, you have testified today that the Federal Government should not help State and local governments in part because "debt-financed spending by the Federal Government pushes costs forward onto younger generations of Americans." You actually made the same argument in 2008 when you opposed Federal aid for State and local governments in the midst of that recession. You wrote, "Spending on a stimulus package would be funded by additional government borrowing, and the burden of that borrowing would fall on young people and future taxpayers." You wrote that in a section you titled "Rising Federal Debt Is Fiscal Child Abuse." Are those your words?

Mr. Edwards. Yeah, that is right. I believe it is.

Mr. Ramamurti. So that phrase, "fiscal child abuse," in my view is a pretty shocking thing to say, especially when you look at what States are being forced to do right now because they are not getting Federal aid. Here are just some of the examples: Alabama and California are cutting funding for early childhood education programs; Wyoming is cutting $10 million from its public pre-school program for kids with disabilities; Oregon is delaying a program to help children from low-income families with mental health issues; and Missouri, New Jersey, and Texas are slashing funds and laying off workers dedicated to protecting children from actual child abuse.

All of these changes will have lasting effects on this generation of kids, especially the most vulnerable among them. So, Mr. Edwards, how much actual harm to kids today are you willing to tolerate based on your concern about so-called fiscal child abuse?

Mr. Edwards. Those children will grow up, and Federal, State, and local governments have been enormously irresponsible by getting the United States enormously into debt. The Federal Government has $20 trillion of bond debt now. Those costs are being pushed forward, so in the future either those spending programs that you mentioned will have to be cut or taxes will have to be raised. An increasing share of the earnings of young Americans in the future will have to go, for example, to pay the foreign creditors, which reduces the U.S. living standard--

Mr. Ramamurti. Okay, so, look, Mr. Edwards--I am sorry. My time is short. But it sounds to me like your answer is you are going to accept quite a bit of harm to kids today based on the concern that, I do not know, I guess the debt will go up, and maybe corporations in America will have to pay slightly more in taxes in the future.

Look, it is incredibly cheap for the Federal--

Mr. Edwards. Those programs you mentioned are State programs, so the State governments, they should make--they should balance the costs and benefits of funding those programs.

Mr. Ramamurti. Mr. Edwards, look, the point I am making--

Mr. Edwards. --Federal issue--

Mr. Ramamurti. Excuse me, sir. The point I am making is that it is incredibly cheap for the Federal Government to borrow right now. The interest rates are under 1 percent for a 10-year repayment term. And I think it is, frankly, perverse to cite your concern for children to justify cuts that will do actual harm to children right now. And I think it is especially perverse coming from a lot of the same folks who happily supported adding $2 trillion in debt a couple years ago to hand tax cuts to big corporations and the rich.

But, look, even setting aside this moral question of whether we should make our kids suffer lasting harm today rather than borrow at record low interest rates, it is also just terrible economic policy. Experts across the political spectrum agree that every dollar of Federal aid to State and local governments produces more than a dollar's worth of economic growth. Mr. Zandi has said that. Glenn Hubbard, who was the Chair of President George W. Bush's Council of Economic Advisers, has said that. And the nonpartisan Congressional Budget Office has said that. They have each found that a dollar of State and local aid produces about $1.20 or $1.30 in growth.

But, Mr. Edwards, you dispute that point in your testimony, citing a single study. You write, "A 2019 review of the academic literature by the University of California's Valerie Ramey suggests that a dollar of Federal aid would actually result in less than a dollar of growth." Is that right?

Mr. Edwards. Yeah, that is absolutely right, and it was not just a single study. She reviewed all the academic economic studies over the last decade, and she concluded that the multiplier for government spending was probably less than one. There is no certainty here, but she thought probably. I would say also--

Mr. Ramamurti. Okay. Thank you. Mr. Edwards, thank you. That is all I wanted to know. But, look, I actually took a careful look at the study, and it also says later that when monetary policy is very accommodative--in other words, when interest rates are low and will be low for a long time--government spending in the United States can generate $1.50 or more in return for every dollar. So as I am sure you know, Mr. Edwards, interest rates are currently at zero, and the Fed announced yesterday that it was percentage to keep them that through 2023.

So do you agree that the study you have cited actually suggests a return of far more than a dollar on every dollar we dedicate to State and local aid right now?

Mr. Edwards. No. I think that there was a lot of uncertainty with what she said about--she called it "zero lower bound." Her main central conclusion was that the multiplier was from about 0.6 to 0.1. And if you look at her other studies on her Web page over the last decade, similarly, you know, they suggest perhaps lower multipliers than other people have found. Dr. Zandi--

Mr. Ramamurti. Thank you, Mr. Edwards, just because my time--and I want to be respectful of the Chair. Look, I agree that there was some uncertainty, and I wanted to be extra sure about all this. So yesterday I called up the author of the study, Professor Ramey, to ask her specifically what she thought, and she wrote me a short letter in response, which I would like to submit for the record. And Ms. Ramey says, "My estimate of the likely multiplier for Federal grants or loans to State and local governments, conditional on the current economic and policy situation, is likely to be somewhere between 1.2 and 1.5." So I am glad that we resolved that question.

[The letter follows:]

/ COMMITTEE INSERT

Mr. Ramamurti. Look, I am running short on time, but if this is the best case against more Federal support to State and local governments, then I think that position is pretty laughable.

Thank you, Madam Chair.

Ms. Shalala. Congressman Hill.

Mr. Hill. Thank you, Madam Chair.

Mr. Gee, let me express all of our thanks to you for helping navigate COVID-19 for Metro St. Louis, and also thank you for your leadership for government finance officers across the country. I cannot think of a more challenging period or more interesting period for that work.

We have talked a lot about the Municipal Liquidity Facility today, but we have also talked about the billions of dollars that have been sent to the States. I know listening to the Missouri congressional delegation, there has been some complaining about the Governor of Missouri's sharing of that money with State and local governments. And I note in the U.S. Treasury IG report that about 26 percent of the money sent to Missouri has been spent to date.

But I looked at St. Louis County, particularly, that got $173 million directly to St. Louis County, and yet in that same IG report, only about 6 percent of it has been spent, $11 million. And I wondered, has St. Louis County shared any of the CARES Act money with you in your official capacity in the sewer and water aspect of Metro St. Louis?

Mr. Gee. Well, thank you, sir, for the question. Let me just start off by pointing out with governmental entities, there is a difference between spent and encumbered. I would argue that the majority of the funds have been encumbered, meaning that they have been earmarked for specific use. It is true that you may have instances in which those dollars have not been spent, but the funds have been encumbered.

With respect to your question regarding the St. Louis County government, we have not requested any CARES Act funding from that governmental entity. I cannot really speak to their finances. I am not part of St. Louis County government.

Mr. Hill. Have you asked for any CARES Act funding from any entity in Missouri, the city of St. Louis, the county of St. Louis, the State of Missouri?

Mr. Gee. We have not requested any CARES Act funding. We have requested some funding from FEMA that would cover some of our PPE-related expenditures.

Mr. Hill. Right, well, I recognize your point, and I accept it on encumbered. That number is a moving target in the States. They will initially legislatively approve a large allocation and then end up not needing it, and so that number is a moving target. In Arkansas, it is well over 80 to 90 percent considered by the legislative council on what they would like to spend the money on, but they have spent far less than that.

Has the State of Missouri, to your knowledge, allocated money to the smaller cities and counties outside St. Louis? To your knowledge, has the Governor allocated money for their use?

Mr. Gee. It is my understanding that funds have been allocated to the counties and the cities, and the counties have allocated funds to some of the smaller cities that were not eligible for a direct allocation.

Mr. Hill. Thank you.

Dr. Zandi, to you, thanks for all your work with our States. I believe we use your forecasting model in the State of Arkansas for our revenue forecasts, so we are grateful for your influence across a lot of economics in our country. And you have been describing the stress that you see in State and local revenues going out to 2022. Do you think the U.S. economy will rebound and have a positive GDP growth in the fourth quarter of this year? And, also, do you think it will have a GDP increase, positive increase, for the calendar year of 2021?

Mr. Zandi. Well, I think it depends on two things, one, the pandemic and how it unfolds, but let us just put that to the side and let us assume that the pandemic remains roughly where it is today in terms of infections and deaths. But the second is whether Congress and the administration are able to come together and pass some additional fiscal rescue support to the economy in the next couple three weeks before you go away for recess.

If you do and it is a substantive package that includes aid to State and local government, then I think we will get a positive quarter. We will get growth that is somewhere 3, 4, 5 percent annualized in Q4. If you do not, if there is no additional support, I think we will likely go back into recession by the end of the year with negative job numbers and rising unemployment. So I think a lot depends on what happens in Washington, D.C., over the next 2 to 3 weeks.

Mr. Hill. Considering that recessionary risk and the pandemic risk, would you recommend in 2021 a $4 trillion increase at the Federal Government level?

Mr. Zandi. I am sorry. A rescue package of $4 trillion?

Mr. Hill. No. Would you recommend a tax increase at the Federal Government level of $4 trillion in fiscal year 2021?

Mr. Zandi. No. I think until the economy is back on its feet and we are, you know, closing in on full employment, I think it is important for the Federal Government to continue to provide significant support both through significant additional spending and I would not raise taxes in any significant way until we are close to full employment.

Once we are at full employment, I do think we need to pivot it, and we need to really focus on our long-term fiscal situation as a Nation. That will require tax increases and government spending will shrink, both--

Mr. Hill. Thank you very much. I yield back.

Mr. Zandi. On that I think we need to be very aggressive. Thank you.

Ms. Shalala. Thank you.

On behalf of the Congressional Oversight Commission, I would like to thank all of our witnesses for their time and testimony today. A special thanks to the Senate Finance Committee for allowing us to use their hearing room. I also want to thank our Commissioners, my fellow Commissioners, for their participation today and for their thought questions; and, of course, our staffs for their assistance with this hearing.

Commissioners may also submit follow-up written questions for the record.

This hearing is now adjourned.

[Whereupon, at 11:44 a.m., the Commission was adjourned.]