Yale SCHOOL OF MANAGEMENT

Home / Centers & Initiatives / Program on Financial Stability / Mnuchin Clarifies that Treasury is Prepared to Lose Money on Fed Programs

Mnuchin Clarifies that Treasury is Prepared to Lose Money on Fed Programs

By: Rosalind Z. Wiggins and Greg Feldberg | May 21, 2020

Access our live "financial-intervention" tracker, which is a single point-of-entry on the YPFS website to keep up with financial-crisis fighting interventions by central banks, fiscal authorities, and international organizations here.

U.S. Treasury Secretary Steven Mnuchin clarified Tuesday that the Treasury is prepared to take losses as it provides unprecedented credit support to the Federal Reserve's COVID-19 lending programs.

"The answer is absolutely yes," Mnuchin said in response to questions from legislators in a virtual hearing of the Senate Banking Committee. "By definition that capital is at risk, and we are fully prepared to take losses, in certain scenarios, on that capital."

In March, Congress made a $500 billion funding pool available to the Treasury Department, part of the $2 trillion CARES Act. The legislation directed the Treasury to allocate up to $46 billion of that amount for airlines and other distressed companies. It directed the Treasury to use the balance of at least $454 billion to support Fed lending programs.

Mnuchin and Fed Chairman Jerome Powell appeared before the Senate Tuesday to present their first quarterly report to Congress on their use of these funds.

On **April 9**, the Fed announced four joint Fed-Treasury programs under the CARES Act. These included facilities for corporate credit; loans to municipalities; loans to small and medium-sized companies (the "Main Street Lending Program"); and asset-backed securities. In total, these programs would commit $195 billion of the $454 billion in taxpayer funds available to the Treasury. Those funds would back up to $1.95 trillion in Fed lending.

Senators in Tuesday's hearing questioned why so little of the $454 billion has been used to date. Only one program has launched: On May 11, the Treasury provided **$37.5 billion** to the Fed to cover half of the promised equity for the **Corporate Credit Facility**. The Fed had lent the facility only **$305 million** as of **May 13,** to buy exchange-traded funds.

Powell said Tuesday he expects all of the new programs to be "stood up and ready to go by the end of this month." The Fed has released term sheets for each new program, and made revisions in some cases in response to thousands of public comments. The facilities are complex and delve into risk areas that are new to the Fed in its lending operations. "People are working literally around the clock and have been for weeks," Powell said.

Treasury to take losses?

In earlier posts, we considered how the Treasury's use of the funding pool authorized by the **CARES Act** to **backstop Fed programs** might leverage the funds into trillions of liquidity for the economy. In earlier comments, Powell has said the Fed could leverage the whole of the Treasury's $454 billion to lend as much as $4 trillion.

The Fed's emergency-lending authority, under **Section 13(3)** of the Federal Reserve Act, requires the central bank to make sure emergency loans are adequately secured and protect taxpayers. A lingering question has been whether the Treasury's potential absorption of losses was consistent with **Section 13(3)**. Although there seemed to be a common consensus developing between Powell and Mnuchin that this was indeed the case, later statements by Mnuchin raised uncertainty.

During an interview on April 9, Powell said: "We do these [programs] with the consent of the…Treasury Secretary and with fiscal backing from the Congress through the Treasury." He also said: "We're using that fiscal backstop to absorb any losses that we have." (**Powell at Brookings**, 11:45-12:45).

However, before Mnuchin's statements Tuesday, it wasn't clear whether the Treasury shared this view.

In March, Mnuchin initially echoed Powell's position, describing the program as **providing trillions of dollars to the economy** with the Treasury's assistance by **"putting up money to support the credit for the Fed."**

But on **April 29**, Mnuchin seemed to indicate that he might be retreating from his earlier stance. He said he was "looking at it in a base case scenario that we recover our money." At that time, he contrasted the Fed lending programs with spending programs also included in the CARES Act. "If Congress wanted me to lose all the money, that money would have been designed as subsidies and grants as opposed to credit support."

Uncertainty regarding how the Treasury's backstop will operate goes directly to the amount of risk that the Fed might undertake in designing its lending programs. The Treasury's willingness to bear losses might result in less stringent, but still prudent, participation standards that could potentially reach a broader number of participants. Commenters and prospective borrowers have questioned whether some of the Fed programs were initially drawn too narrowly to provide the intended assistance.

At the hearing Tuesday, Mnuchin sought to put the discussion to rest and provide clarity. "For any facility that the Fed believes puts them at risk, I do put up capital, so by definition that capital is at risk, and we are fully prepared to take losses, in certain scenarios, on that capital." While his response was emphatic, the allusion to "certain scenarios" suggests some ambiguity. Mnuchin's prepared testimony is **here**.

Fed's language evolves

The Fed has consistently said in its required **reports** to Congress on the emergency lending programs that it is comfortable that it won't lose money in part because the Treasury has agreed to take losses first. Powell repeated that in his prepared **testimony** Tuesday. But the language has evolved.

In its **March 29 report** on the Term Asset-Backed Securities Loan Facility (TALF), the Fed wrote: "As TALF credit is non-recourse to the borrower, the Federal Reserve and the Department of the Treasury, through its equity investment, will bear the risk of loss on the collateral… The Board does not expect at this time that the TALF will result in losses in excess of the Department of the Treasury's equity investment. Accordingly, the TALF is not expected to result in losses to the Federal Reserve or the taxpayer." It used similar language in other 13(3) reports in March.

In April, though, the **Fed has used** slightly different wording in its reports to Congress. It deemphasizes the loss-bearing nature of the Treasury's equity investments. But it has also dropped the expectation that programs will not result in losses to the taxpayer. For example, the **April 28 report s**aid, "As described in the Board's initial report to Congress regarding the TALF, the TALF includes features that are intended to mitigate risk to the Federal Reserve. The Board continues to expect that the TALF will not result in losses to the Federal Reserve" (italics added).

Fed has lent $120 billion through other facilities in the COVID-19 crisis

The Fed launched its first COVID-19 emergency lending facilities for financial markets in March in the weeks before Congress passed the CARES Act. These facilities mirrored facilities the Fed created during the global financial crisis of 2007-09.

As of **May 13**, the Fed had roughly $120 billion outstanding in loans through its discount window and a half-dozen emergency facilities. Two of these facilities – the Money Market Mutual Fund Liquidity Facility and the Commercial Paper Funding Facility – are each backed by $10 billion in loss-bearing equity that the Treasury agreed to provide prior to the passage of the CARES Act (see the YPFS **blog**).

The Fed also has roughly $450 billion outstanding in swaps with foreign central banks to provide liquidity in dollar-denominated assets.

The video and transcript of the entire hearing can be accessed **here**.

Yale SCHOOL OF MANAGEMENT

Educating leaders for business and society.

Edward P. Evans Hall
165 Whitney Avenue
New Haven, CT 06511-3729

GLOBAL NETWORK FOR ADVANCED MANAGEMENT

Get Yale SOM News **Apply Now**

Business & Society

Programs

Case Studies

Giving

Contact

SOM Directory↗

Alumni Directory↗

Campus Groups↗

Recruiters↗

Yale Insights↗

The Global Network↗

Instagram↗

LinkedIn↗

Twitter

Facebook

YouTube

Site Map **Terms of Use** **Privacy Policy** **Accessibility**