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The Uncertain Future of the Fed's CARES Act Facilities

# The Uncertain Future of the Fed's CARES Act Facilities

By Steven Kelly | December 8, 2020



After a rare public disagreement with the Treasury, the Federal Reserve says it will return the bulk of the funds that the Treasury provided to buttress the Fed against any losses on four emergency lending programs. The Treasury, in turn, has stated its intent to transfer all unused funds that Congress had allocated to it for use in the Fed facilities to its General Fund by year-end.

On November 19, Treasury Secretary Steven Mnuchin sent a **letter** to Fed Chair Jerome Powell discussing the future of the Fed's current set of **Section 13(3)** emergency lending facilities. The Secretary stated that he will not extend the four emergency lending facilities that use funds from the **Coronavirus Aid, Relief, and Economic Security (CARES) Act** after December 31. He asked the Fed to return the Treasury's unused funds for those facilities, all but approximately \$25 billion – the amount it has extended to borrowers under the four facilities. This would require the Fed to return about \$78 billion of the money it has received so far from Treasury.

The letter also requested a three-month extension of a separate set of four facilities that do not use CARES Act funding. These facilities currently have extended about \$60 billion in total credit.

On November 19, the Fed released a public **response** to Mnuchin: “The Federal Reserve would prefer that the full suite of emergency facilities established during the coronavirus pandemic continue to serve their important role as a backstop for our still-strained and vulnerable economy.”

The next day, though, Chair Powell **confirmed** the Fed would return the unused portions of the funds allocated to the CARES Act facilities as Mnuchin had requested.

In the CARES Act, passed on March 27, Congress allocated \$454 billion to the Treasury to provide loss-bearing support for Fed facilities to lend to a variety of businesses, nonprofits, and government entities. Of that amount, Treasury committed \$195 billion to four programs the Fed created earlier this year. It has disbursed a total of \$102.5 billion of that committed amount to the Fed. To date, the Fed has committed \$25 billion of loans and assets purchases under these programs.

Mnuchin's decision means that the Fed will return about \$78 billion of the \$102.5 billion it has received, and retain \$25 billion. The Treasury will then transfer \$429 billion of the

\$454 billion set aside for Fed programs from its **Exchange Stabilization Fund (ESF)** back into its General Fund.

The Treasury also used its Exchange Stabilization Fund funds prior to the passage of the CARES Act to support two lending facilities that the Fed established, the Commercial Paper Funding Facility (CPFF) and the Money Market Mutual Fund Liquidity Facility (MMLF). It has disbursed \$11.5 billion to the Fed for these programs of the \$20 billion it has committed. The MMLF now has \$4.9 billion in outstanding loans; the CPFF has none.

The Treasury Secretary noted that it still has available pre-CARES Act funds in the Exchange Stabilization Fund. These amount to roughly \$75 billion; the Fed and Treasury could access these funds without new Congressional authorization. Mnuchin **has said** that the Fed could leverage those remaining funds to provide up to \$800 billion in new lending, if necessary.

Earlier in the year, the Fed had said its emergency lending could reach **up to \$4 trillion** using the CARES Act funds to protect it from losses.

### *Secured to the Satisfaction*

The Fed's **Section 13(3)** emergency lending programs require the ongoing approval of the Treasury Secretary under 2010 revisions to the Federal Reserve Act. Under Section 13(3), any emergency lending also must be "secured to the satisfaction" of the Federal Reserve. The 13 programs the Fed created this year have varying setups for absorbing losses – broadly falling into three buckets.

In the first bucket are the **Paycheck Protection Program Liquidity Facility** and **Primary Dealer Credit Facility**, which have no equity support from the Treasury as designed. The PPPLF currently has about \$55 billion in outstanding loans to businesses; the PDCF has about \$250 million.

In the second bucket are the **CPFF** and **MMLF**. The Treasury agreed to give both programs \$10 billion of equity protection from the Treasury's Exchange Stabilization Fund.

In his November 19 letter, Secretary Mnuchin asked the Fed's board to approve an extension of these four facilities. The CPFF had previously been set to expire on March 17, 2021; the Fed had earlier **extended** the other three programs' expiration to December

31, 2020 with Treasury approval. On November 30, the Fed said it would **extend** these four programs to March 31, 2021.

In the third bucket are the programs that have equity funding the Treasury provided under the CARES Act. These facilities may purchase corporate bonds and loans, municipal bonds, and asset-backed securities (the **Corporate Credit Facility** (CCF), **Main Street Lending Program** (MSLP), **Municipal Liquidity Facility** (MLF), and **Term Asset-backed Securities Loan Facility** (TALF)). On April 9, the Treasury announced that it intended to use CARES Act funds to purchase equity in these facilities. The Fed would leverage the Treasury's equity as much as 10 or 14 times, depending on the type of loan or asset it purchased.

### *The Future of Emergency Lending*

Both Mnuchin's and Powell's letters reiterated that the Fed and Treasury would still be able to use the rest of Treasury's unused Exchange Stabilization Fund funds that pre-date the CARES Act. These **funds** amount to **about \$75 billion**. Indeed, the Fed **originally announced** that the Treasury would backstop the CCF and TALF with this core Exchange Stabilization Fund funding before Congress passed the CARES Act.

There remains some legal uncertainty about the return of the CARES Act funds. In his letter, Secretary Mnuchin cited "Congressional intent" for the Fed facilities to make no new loans after December 31. However, the Fed's initial response on November 19 expressed a preference for the facilities to remain active beyond that date. Powell's November 20 letter did not address Mnuchin's legal argument; it deferred to the Secretary, acknowledging that the Secretary had "indicated that the limits on [the Secretary's] authority do not permit the CARES Act facilities to make new loans or purchase new assets after December 31, 2020." Powell's **testimonies** to Senate and House committees on December 1-2 echoed this position, **saying** the Treasury Secretary has "sole authority over [CARES] funds."

The CARES Act refers to the Treasury's ability to make new disbursements and **does not affect** the Fed's emergency lending authority. The contracts associated with the CARES Act facilities call for agreement from the Fed and the Treasury to reduce the scope of the facilities. (See the Fed's and Treasury's **Limited Liability Company Agreements** setting up the facilities; for instance in the case of the CCF, see pages 7-9 **here**.) This is consistent with the process for the wind-down of the 2008-era TALF.



The only Fed facility with an injection of subordinated funds from the Treasury during the GFC, the **2008 TALF**, was supported by \$20 billion of **TARP** funds—intended to enable up to \$200 billion of lending. When the facility closed to new loans in 2010, just \$43 billion in loans were outstanding. Within a month, the Federal Reserve and Treasury **agreed** to downsize the Treasury's position to \$4.3 billion. That amount reflected a loss-bearing investment that would be consistent with the 10-to-1 leverage ratio built into the facility's design.

The future of the facilities under a new presidential administration remains unclear. A future Treasury Secretary may **deem it legal** to restore the \$195 billion of CARES Act funds that the Treasury had previously committed to the Fed lending facilities.

Mnuchin has stated his intent to **move the returned funds** from the ESF to the Treasury's General Fund—a fund which requires specific congressional approval to access. The CARES Act does not require unused funds to be moved from the ESF to the General Fund until 2026. Rather, the CARES Act **stipulates** that any funds remaining on January 1, 2021 of those allocated to the Treasury's ESF “may be used only for modifications, restructurings, or other amendments of loans, loan guarantees, or investments.” It may thus be the case that a new administration's Treasury determines Mnuchin's accounting move inconsistent with the law **and undoes** Mnuchin's transfer of CARES Act funds from the ESF to the General Fund. If the funds remain in or are returned to the ESF, it **could also be the case** that a move by the Treasury and Fed to increase the size of the previously committed equity injections might be deemed **legally consistent with the “amendment” authority available until 2026**.

Furthermore, the Fed and Treasury designed the CARES Act facilities to leverage the Treasury's equity several times over—over 14 times **in the case of the MLF**—with the Fed's loan funding. The Fed deemed the Treasury equity necessary to bear losses so its loans to nonfinancial borrowers would be secured to its satisfaction, consistent with Section 13(3). However, Secretary Mnuchin has elected to leave \$25 billion behind—which covers all of the outstanding credit these facilities have extended, rather than just Treasury's equity tranche. This contrasts with how it downsized the 2008-era TALF. In that case, the Treasury retained just its equity tranche in order to provide leverage for the Fed. It thus remains possible that the next Treasury Secretary could authorize the Fed to extend substantially more credit without allocating any additional equity funds. Such a move

would give the Fed's CARES Act facilities approximately \$250 billion of lending/purchasing capacity.

Restoring the full \$195 billion to the facilities would return them to their stated \$1.95 trillion capacity. An interpretation of the CARES Act's amendment authority that allowed uncommitted funds to increase the size of the existing facilities would lead to greater capacity still. If the unassigned \$209 billion of the \$454 billion originally allocated by the CARES Act was restored to the ESF and available to support existing facilities, the originally envisaged backstop capacity of approximately \$4 trillion would again be available.

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