DEPARTMENT OF THE TREASURY
WASHINGTON, D.C. 20220

October 16, 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 September 29, 2020 letter enclosing questions from the Congressional Oversight Commission and individual commissioners regarding the Municipal Liquidity Facility established under the Coronavirus Aid, Relief, and Economic Security Act.

The Department of the Treasury remains committed to working with the Commission to accommodate its interest in these and other issues. To this end, responses to the questions included with your September 29 letter are enclosed.

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

Sincerely,

Frederick W. Vaughan

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

Enclosure

Enclosure: ***Department of the Treasury Responses to Questions from the Congressional Oversight Commission Regarding the Municipal Liquidity Facility***

Questions Submitted from the Congressional Oversight Commission

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

Response: Secretary Mnuchin and Chair Powell agreed on the policy goals of the program in light of events in the municipal bond market and the broader economy. The terms and conditions of the Municipal Liquidity Facility were determined by joint discussions between the Board of Governors of the Federal Reserve System (Federal Reserve) and the Department of the Treasury.

The Federal Reserve performed the necessary financial, legal, and market analysis, developed proposed terms and conditions, created the program documentation and website, and operationalized the Municipal Liquidity Facility in accordance with Section 13(3) of the Federal Reserve Act and Regulation A. Treasury and Federal Reserve staff jointly reviewed events in the municipal bond market and the status of state and local government finances.

Treasury reviewed and approved the creation of the facility and all the term sheets and frequently asked questions prior to their release. Treasury also approved the use of funds appropriated to the Exchange Stabilization Fund under the Coronavirus Aid, Relief, and Economic Security (CARES) Act, making a $35 billion commitment to the special purpose vehicle (SPV) established by the Federal Reserve Bank of New York in connection with the Municipal Liquidity Facility.

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

Response: Secretary Mnuchin and Chair Powell had discussions multiple times weekly regarding each of the facilities created by the Federal Reserve using funds from Treasury under the CARES Act, including the Municipal Liquidity Facility. In connection with these regular discussions, the Secretary approved the Municipal Liquidity Facility and the Treasury funding and reviewed all term sheets and frequently asked questions, as well as economic and market analyses developed by the Federal Reserve.

Questions Submitted from Commissioner Bharat Ramamurti and 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

***Response*:** Following discussions with the Federal Reserve on the Federal Reserve's analysis of the appropriate size of the Municipal Liquidity Facility, and based on the Federal Reserve's modeling of potential losses by the facility, the Federal Reserve and Treasury determined the percentage of equity from Treasury required to support the facility, and the Federal Reserve and Treasury worked to determine the appropriate size of the facility.

With respect to the original design and various terms of the Municipal Liquidity Facility, the Federal Reserve and Treasury came to agreement on the needs and policy goals of the program, based on municipal financing needs and the authorities under the CARES Act and the Federal Reserve Act. Federal Reserve economists, market analysts, and other staff conducted the necessary research and market outreach and developed the terms, conditions, structure, and operating model for the facility. Treasury reviewed and approved the terms and conditions of the Municipal Liquidity Facility consistent with the agreed-upon needs and policy goals.

Regarding the various revisions to the facility, the Federal Reserve and Treasury discussed feedback from the market and state and local governments on the facility, and the evolving conditions of the municipal bond market. The Federal Reserve conducted the additional research and analysis, developed amendments to the facility term sheet, and adjusted its operating model as informed by this additional information. Treasury reviewed the amendments in light of participant feedback and market conditions, as well as the original policy goals of the facility.

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.

Response: Treasury and the Federal Reserve engaged in extensive deliberations regarding the Municipal Liquidity Facility and worked together to reach agreement on the appropriate structure, terms, and conditions of the facility. Treasury did not decline any formal proposal.

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?

Response: Section 13(3) of the Federal Reserve Act grants statutory authority to the Federal Reserve to determine the rates charged on its lending facilities, with prior approval of the Secretary. On August 11, 2020, the Federal Reserve reduced the pricing methodology to determine the rates for borrowing from the Municipal Liquidity Facility.

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

Response: Treasury does not currently believe the rates should be decreased. The reduction of the facility's rates on August 11 enables the Municipal Liquidity Facility to continue to operate as a backstop in supporting market access by state and local governments.

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?

Response: Section 13(3) of the Federal Reserve Act grants statutory authority to the Federal Reserve to determine the term length under its lending facilities, with prior approval of the Secretary of the Treasury. The CARES Act does not impose term length restrictions on amounts borrowed under Section 13(3) lending programs.

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

Response: Treasury does not currently believe the term length should be increased. The Federal Reserve and Treasury continue to monitor market stability and issuer market access.

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

Response: Reduced overall spending by state and local governments could contribute to a short-term decline in GDP.

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

Response: Federal funding, in the form of grants or direct aid, and Federal financing, in the form of loans including through the Municipal Liquidity Facility, are separate and distinct policy tools. One or the other may be employed, or they may be employed together, depending on the policy goals and the expected costs to the taxpayer.

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

Response: As provided in section 4003 of the CARES Act, the purposes of the Municipal Liquidity Facility include "to provide liquidity to eligible businesses, States, and municipalities related to losses incurred as a result of coronavirus" and to "provid[e] liquidity to the financial system that supports lending to eligible businesses, States, or municipalities."

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"?

Response: Yes. The municipal market's recovery since March and the Municipal Liquidity Facility's continued operation serving as an effective backstop are accomplishing this purpose for issuers.

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

Response: At this time, the Treasury Department does not believe that the Municipal Liquidity Facility should be extended beyond its current expiration date of December 31, 2020. The Federal Reserve and Treasury continue to monitor market stability and issuer market access in order to determine whether any changes to this expiration date would be warranted.

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?

Response: The facility's low utilization reflects a recovered and functioning municipal securities market. Indeed, the municipal securities market stabilized in large part because the Municipal Liquidity Facility established a backstop. Treasury does not believe the facility requires a change to the definition of eligible issuers.

Questions Submitted 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?

Response: Section 13(3) of the Federal Reserve Act grants statutory authority to the Federal Reserve to determine the term length under its lending facilities, with prior approval of the Secretary of the Treasury. The CARES Act does not impose term length restrictions on amounts borrowed under Section 13(3) lending programs.

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

Response: Congress appropriated funding to pay for losses in facilities established under Section 4003(b)(4) of the CARES Act, and the funds contributed by Treasury to the Municipal Liquidity Facility SPV under such authority are both legally and economically exposed to any potential losses that may be incurred by the program. Importantly, Section 13(3) of the Federal Reserve Act additionally requires that facility loans be secured "sufficient[ly] to protect taxpayers from losses," and collateral be assigned a "lendable value" that is "consistent with sound risk management practices … to ensure protection for the taxpayer." The terms of the program have been designed to meet these statutory requirements as well.

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

Response: As noted above, funds contributed by Treasury to the Municipal Liquidity Facility SPV are both legally and economically exposed to any potential losses that may be incurred by the facility. A range of potential outcomes is possible: while Treasury may not experience losses on its investment in the facility, in other cases Treasury could experience losses. While Treasury does not consider taxpayer losses a desirable policy outcome, the incurrence of losses would be acceptable.

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

Response: Treasury committed $35 billion as a backstop to the Municipal Liquidity Facility. Treasury does not currently anticipate any losses on this facility, but Treasury could experience a loss up to the amount of that backstop that is drawn by the facility's SPV.

Question Submitted 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?

Response: Treasury does not currently believe the Municipal Liquidity Facility should continue to serve as a backstop after its scheduled end date of December 31, 2020.