The Main Street Lending Program and Other Federal Reserve Actions

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Remarks to the New England Council

May 19, 2020
Introductory Observations

- The U.S. economy has experienced a severe economic shock from the pandemic
  - So far not able to fully halt community spread
  - Economic challenges rooted in public health concerns
- Reopening is not a panacea for our economic challenges
  - Households must be willing to spend
  - Employees must feel it is safe – and logistically possible – to return to work
  - Firms need to be comfortable making new investments
- Social distancing is necessary but costly
  - It is important that the sacrifices and progress made are not undone
  - Health policy must limit the risk of second waves of the virus
Important Role of the Federal Reserve

- Central banks play a powerful role during crises
- To reduce financial spillovers from the shock to the economy:
  - Reduced short-term interest rates to near zero
  - Purchased securities to stabilize markets
  - Maintained credit flows to households and businesses
- New lending facilities are an important tool
  - Important to note: powers granted to the Fed for emergency and exigent actions involve lending, not spending
Today I’ll focus on two of the Federal Reserve’s lending programs being run by the Boston Fed:

Money Market Mutual Fund Liquidity Facility
- Alleviate disruptions in short-term credit markets
- Reduce outflow of funds from prime money market mutual funds

Main Street Lending Program
- Loans to businesses affected by the pandemic
- Will operate through three facilities – the New, Priority and Expanded loan facilities
- Opening in the coming weeks
Figure 1: Civilian Unemployment Rate
January 2007 - April 2020

Source: BLS, NBER, Haver Analytics
Figure 2: Payroll Employment Declines in Selected Industries
February 2020 - April 2020

Source: BLS, Haver Analytics
Figure 3: Payroll Employment Declines in Selected Industries
February 2020 - April 2020

Job Losses in Millions, February to April

- Accommodation and Food Services
- Retail Trade
- Health Care
- Manufacturing
- Arts, Entertainment, and Recreation
- Construction
- Temporary Help Services
- Social Assistance
- Transportation and Warehousing

Source: BLS, Haver Analytics
Figure 4: Employment in Selected Industries Impacted by the Pandemic as a Share of Total Payroll Employment
February 2020

Source: BLS, Haver Analytics
Figure 5: Share of Spending in Category by Age Group
Average, 2017 and 2018

Source: BLS – Consumer Expenditure Survey, Haver Analytics
Reopening the Economy

- Allowing businesses to reopen is not a panacea
- Until community spread is reduced – many firms will face reduced demand
- Proper public health solutions are paramount
  - Cannot return to full employment without public health solutions
  - It is vital that the design and timing of reductions in business restrictions not result in worse health outcomes and higher unemployment over a longer period of time
Federal Reserve Actions

- Intend to mitigate the spillover of problems from the financial realm to the real economy of household and business activity.

- Powers granted to the Fed for emergency and exigent actions involve *lending*, not spending.
  - Facilities offer loans that are to be repaid, they are not grants by the Fed.
  - Lending can play a crucial role in a crisis and in bridging to more normal conditions.
Money Market Mutual Fund Liquidity Facility

- Addresses two problems
  - Short-term debt instruments were not trading efficiently; had unusually wide spreads and little volume
  - Prime money market funds facing rapid redemptions – forcing sales at “fire sale” prices

- Disrupted short-term debt markets create economic problems
  - Reduce supply of credit to businesses
  - Potential investment losses for investors
  - Loss of public confidence impacts households and businesses that invest in these funds
Figure 6: 90-Day Yields on Highly-Rated Commercial Paper
February 18, 2020 - May 15, 2020

Note: Commercial paper rates are composites of offered levels for A1/P1/F1-rated U.S. commercial paper programs. The MMLF is the Money Market Mutual Fund Liquidity Facility. The MMLF lending rate is the rate on loans from the Federal Reserve Bank of Boston to eligible banks made under the MMLF that are secured by commercial paper, including asset-backed commercial paper, and certificates of deposit.

Source: Bloomberg Finance L.P., Federal Reserve Board, Haver Analytics
Figure 7: Daily Change in Prime and Government Money Market Fund Assets Under Management
February 18, 2020 - May 15, 2020

Source: iMoneyNet
Figure 8: Prime and Government Money Market Fund Assets Under Management
February 18, 2020 - May 15, 2020

Source: iMoneyNet
Main Street Lending Program

- Goal: help credit flow to small- and medium-sized businesses that were in good financial condition prior to the crisis

- Differs from other lending facilities
  - Not focused on market-traded securities
  - Bank loans reflect negotiated terms between borrower and lender
  - Smaller companies have less public information available
  - Credit risk evaluation more difficult

- Differs from other programs authorized in CARES Act
  - Loans need to be repaid – no grant feature (as in PPP)
  - No loan guarantee from government (SBA guarantees for PPP)
  - Both borrower and lender must be eligible
Figure 9: Main Street Lending Program

Main Street Borrowers

Main Street Lenders

Bank funds loan

Firm applies for loan

Bank applies to SPV

SPV takes 95/85 split; bank retains 5/15

Federal Reserve Bank of Boston

U.S. Treasury

Up to $75 billion in equity

Up to $600 billion in loans

Main Street Special Purpose Vehicle

Main Street New Loan Facility

Main Street Priority Loan Facility

Main Street Expanded Loan Facility

95/5

85/15

95/5
Setting Expectations

- Aimed at lending to mid-sized and small entities too big for the PPP and too small for other emergency credit facilities
  - Enterprises of this sort accounted for a major share of the U.S. workforce
  - Loans to support their ability to continue until the pandemic is contained and the recovery ensues
    - Minimum loan size is $500,000
    - Maximum is $200 million (in the expanded facility)
- Businesses will not come directly to the Fed – will work with an eligible lender
  - Determine if they meet minimum requirements
  - Banks will underwrite the loan
  - The Fed will participate with the bank in the lending, purchasing 85 or 95 percent of the loan, depending on program facility
<table>
<thead>
<tr>
<th></th>
<th>Main Street New Loan Facility</th>
<th>Main Street Priority Loan Facility</th>
<th>Main Street Expanded Loan Facility</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Term</strong></td>
<td>4 Years</td>
<td>4 Years</td>
<td>4 Years</td>
</tr>
<tr>
<td><strong>Rate</strong></td>
<td>LIBOR + 3%</td>
<td>LIBOR + 3%</td>
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</tr>
<tr>
<td><strong>Prepayment</strong></td>
<td>Yes</td>
<td>Yes</td>
<td>Yes</td>
</tr>
<tr>
<td><strong>Principal and Interest</strong></td>
<td>Deferred for one year</td>
<td>Deferred for one year</td>
<td>Deferred for one year</td>
</tr>
<tr>
<td><strong>Loan Size</strong></td>
<td>$500,000 - $25 million</td>
<td>$500,000 - $25 million</td>
<td>$10 million - $200 million</td>
</tr>
<tr>
<td><strong>Bank Stake</strong></td>
<td>5%</td>
<td>15%</td>
<td>5%</td>
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*Source: Federal Reserve Board*
Figure 11: Main Street Lending Program: Qualifying for Program

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<td>Bank Stake</td>
<td>5%</td>
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<td>5%</td>
</tr>
<tr>
<td>Internal Bank Rating as of December 31, 2019</td>
<td>Pass</td>
<td>Pass</td>
<td>Pass</td>
</tr>
<tr>
<td>Adjusted Debt/EBITDA</td>
<td>4x</td>
<td>6x</td>
<td>6x</td>
</tr>
</tbody>
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Note: EBITDA is earnings before interest, taxes, depreciation and amortization.
Source: Federal Reserve Board
Figure 12: Main Street Lending Program: Information Resources

- Visit [www.bostonfed.org/mslp](http://www.bostonfed.org/mslp) for:
  - FAQs
  - Term sheets
  - Mailbox to reach us (mslp@bos.frb.org)
  - Sign up to receive program updates by email

- Upcoming webinars on the program (details to follow):
  - Lender *Ask the Fed* drop-in session (Q&A) – May 22
  - Lender *Ask the Fed* webinar (presentation & Q&A) – May 28
  - Business borrower webinar (presentation & Q&A) – May 29
  - Business borrower drop-in session (Q&A) – June 3

- Also evaluating feasibility of support of non-profits, asset-based borrowers
Concluding Observations

- Economy has suffered a severe shock from the pandemic
- Even when businesses are free to open, the economy faces significant challenges
  - Many firms may face diminished demand
  - Customers must feel secure leaving their homes
  - Public health is the root of the crisis and its solution
- Unemployment likely to remain elevated
  - Peak close to 20 percent; double digits at end of year
- Sobering, but a call to action: Time to act boldly
- Fed has taken strong action and will continue to pursue ways to return to full employment