Financial Stability

Eric S. Rosengren
President & CEO
Federal Reserve Bank of Boston

Official Monetary and Financial Institutions Forum
Fed Week: Financial Stability Session

June 25, 2021
Exploring Three Financial Stability Challenges

► Periodic disruptions to short-term credit markets
  ► Role of Money Market Mutual Funds (MMMFs)
  ► Other potential cash management alternatives
  ► New disruptors – for example Tether

► Need for emergency lending facilities and regulatory changes in crises
  ► Extraordinary actions were required
  ► Despite efforts, many programs seem better suited to larger institutions and firms
  ► Need a less ad hoc approach

► Possible risks in housing
  ► Residential housing prices showing some exuberance
  ► Real estate has played a role in financial stability problems in the past
In addition to ABCP-UST spreads, other measures of short-term funding market stress also spiked in 2008 and 2020, including unsecured CP-UST, etc.

Source: Bloomberg Finance L.P., Federal Reserve Board, Haver Analytics
Note: In 2014, the SEC adopted MMMF reforms that had two main components: (1) a requirement that institutional prime and tax-exempt MMMFs transact at a variable price rather than the fixed price that had previously been used, (2) a requirement that the board of prime and tax-exempt MMMFs be permitted to levy fees or freeze redemptions if the fund’s weekly liquid assets were to fall below 30% of its net assets. The effective date of these reforms was October 14, 2016.

Source: iMoneyNet
Figure 3: Net Assets in Other Cash Management Funds
2016:Q1 - 2021:Q1

Note: Short-term investment fund data are limited to the six largest short-term investment fund sponsors that are Call Report filers.

Figure 4: Stablecoin Market Capitalization Relative to Prime Money Market Mutual Fund Assets Under Management
October 6, 2014 - June 23, 2021

Source: Coin Metrics, iMoneyNet
## Figure 5: Tether’s Asset Breakdown
**as of March 31, 2021**

<table>
<thead>
<tr>
<th>Assets</th>
<th>USD Billions</th>
<th>Percent</th>
</tr>
</thead>
<tbody>
<tr>
<td>Cash</td>
<td>1.2</td>
<td>2.9</td>
</tr>
<tr>
<td>Treasury Bills</td>
<td>0.9</td>
<td>2.2</td>
</tr>
<tr>
<td>Reverse Repo Notes</td>
<td>1.1</td>
<td>2.7</td>
</tr>
<tr>
<td>Fiduciary Deposits</td>
<td>7.5</td>
<td>18.4</td>
</tr>
<tr>
<td>Commercial Paper</td>
<td>20.3</td>
<td>49.6</td>
</tr>
<tr>
<td>Secured Loans</td>
<td>5.1</td>
<td>12.5</td>
</tr>
<tr>
<td>Corporate Bonds, Funds, and Precious Metals</td>
<td>4.1</td>
<td>10.0</td>
</tr>
<tr>
<td>Other Investments</td>
<td>0.7</td>
<td>1.6</td>
</tr>
<tr>
<td>Total Assets</td>
<td>41.0</td>
<td>100.0</td>
</tr>
</tbody>
</table>

*Source: Tether*
Regulatory Relief Instituted to Promote Lending during Crisis

► Allowed lenders to provide loan modifications without classifying the loan as a troubled debt restructuring
► Capital ratio adjustment for large banks (SLR) which removed Treasuries and deposits at Federal Reserve Banks from the denominator of the capital ratio
► Reduced the impact of the new accounting rules (CECL)
► Reduced capital requirement on community banks from 9 percent to 8 percent (for Community Bank Leverage Ratio “CBLR” adopters)
► Encouragement to use capital buffers
► Suspension of share repurchases and limitations on dividends
Promoting Credit Availability during Crisis

► Emergency lending facilities to support key asset market functioning:
  ► PDCF (Primary Dealer Credit Facility)
  ► MMLF (Money Market Mutual Fund Liquidity Facility)
  ► CPFF (Commercial Paper Funding Facility)
  ► TALF (Term Asset-Backed Securities Loan Facility)

► Direct lending to private businesses/corporations that replaced bank lending/bond issuance:
  ► PPP (Paycheck Protection Program)
  ► MSLP (Main Street Lending Program)
  ► PMCCF and SMCCF (Primary and Secondary Market Corporate Credit Facilities)
Figure 6: Programs Established to Provide Credit to Small- and Mid-Sized Borrowers

<table>
<thead>
<tr>
<th>Program</th>
<th>Paycheck Protection Program</th>
<th>Main Street Lending Program</th>
</tr>
</thead>
<tbody>
<tr>
<td>Target Firms</td>
<td>Small-sized (≤500 employees)</td>
<td>Small- and medium-sized</td>
</tr>
<tr>
<td></td>
<td></td>
<td>• &lt;15,000 employees OR  • &lt;$50 billion in revenue</td>
</tr>
<tr>
<td>Loan Size</td>
<td>Max = $10 million</td>
<td>Max = $300 million</td>
</tr>
<tr>
<td></td>
<td>Average = $67,600</td>
<td>Average = $9.5 million</td>
</tr>
<tr>
<td>Max Outstanding Balances</td>
<td>$800 billion</td>
<td>$17.5 billion</td>
</tr>
<tr>
<td>Number of Loans</td>
<td>11,823,594</td>
<td>1,830</td>
</tr>
</tbody>
</table>

Note: The Paycheck Protection Program is a Small Business Administration program. The Main Street Lending Program is a Federal Reserve program. Paycheck Protection Program loans are potentially forgivable if certain criteria are met. Main Street Lending Program loans are full-recourse loans and not forgivable.

Source: Federal Reserve Bank of Boston, Federal Reserve Board, Small Business Administration
Figure 7: C&I Lending and the Paycheck Protection Program (PPP): Small Domestic Banks
January 1, 2020 - June 2, 2021

Note: Small domestic banks are defined as all domestic commercial banks minus the 25 largest domestically chartered commercial banks. Data are weekly.
Source: Federal Reserve Board, Small Business Administration, Haver Analytics
Figure 8: Change in U.S. Bond Issuance
March 2020 - June 2020

Year-over-Year Change in Monthly Bond Issuance in Billions of Dollars

- Mar-2020
- Apr-2020
- May-2020
- Jun-2020

Source: SIFMA
Figure 9: U.S. Metro Area Home Price Indices
January 2000 - March 2021
Index, January 2000=100

Note: Indices are repeat-sales indices.

Source: S&P/Case-Shiller, Haver Analytics
Concluding Observations

► Short-term credit markets have been disrupted in the past two recessions, and significant risks remain

► Substantial actions were taken to support lending during the pandemic
  ▶ We need to be less dependent on ad hoc measures
  ▶ A properly implemented CCyB would avoid some of these issues

► Emergency facilities were more effective at supporting large firms
  ▶ We need better ways to reach small firms in economic downturns
  ▶ Without better facilities for small firms, the situation will increase economic concentration

► Housing prices have caused financial stability problems in the past
  ▶ Recent housing price trends should be monitored closely by policymakers