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Federal Reserve Bank of Boston®

"The Main Street Lending Program and Other Federal Reserve Actions"

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The views expressed today are my own, not necessarily those of my colleagues on the Federal Reserve Board of Governors or the Federal Open Market Committee.

Good afternoon. Thank you for the opportunity to offer some remarks and information during this incredibly challenging time for New Englanders and all Americans. People in households across the country are coping with illness, working on front lines, and adjusting to new realities and uncertainties. Most Americans are concerned about the impact of the public health crisis on their family and friends; and worry about their financial health too, given the severe economic consequences of the pandemic.

Unfortunately, the pandemic and the absolutely necessary response, aimed at protecting lives and health, involve a high cost to the economy – which was so recently doing very well. The economic shock is an unprecedented challenge for economic policymakers including the Federal Reserve, where we will do whatever we can to support a return to full employment and stable prices – our mandate from Congress – and our commitment to financial stability, which is important to the well-being of all Americans.

Public health concerns are driving the economic challenges we face, so as an economic policymaker I have to analyze a range of medical and public health issues. Unfortunately, in the United States we have so far not been able to fully halt community spread of the virus, and many states are now relaxing restrictions even while infections and deaths remain a major concern. While allowing employers to reopen will enable some people to return to work, it is not a panacea for our economic challenges, which again are rooted in public health concerns. It is possible that many households will remain reluctant to spend, and employees may be reluctant to return to the workplace – either because of their own health concerns, the lack of open daycare facilities or schools for their children, or to protect or take care of other family members. Some firms may be reluctant to invest, until community spread of the virus has been significantly reduced. The optimal mix of public health and economic policies is complex, making economic forecasts at this juncture unusually uncertain.

To be sure, the economic pain ushered in by the pandemic is extraordinary. The recent employment report[1] underscores the unprecedented speed and ferocity with which jobs have been affected by this public health crisis. Social distancing and quarantine are essential health policy measures, but costly. It is important that the sacrifices and progress made so far not be undone. This requires that health policy measures limit the risk of second waves of the pandemic, to the extent possible.

From an economic policy standpoint, my view is that measures should be taken to limit the potential for medium- and longer-term "scarring" from the crisis. This means, among other things, minimizing the length of unemployment spells, and ensuring that solvent firms have the liquidity necessary to weather the crisis. As a result, it is very important that we maintain resolve to do whatever is necessary to restore the public health *and* economic health of the United States as quickly as possible.

Central banks can play a powerful role in crises. Some of the more significant financial spillovers recently have been mitigated by the actions of the Federal Reserve.[2] For example, the panic selling that hit financial markets in March was largely offset by the Fed – by reducing short-term interest rates to near zero, and setting up emergency lending facilities and purchasing securities to support the credit needs of U.S. households and businesses. Preventing bouts of financial instability from having significant spillovers to the flow of credit to consumers and businesses is a vital crisis role for central banks, and the Fed has aggressively played that role during this very challenging period.

In my remarks today, I will provide a brief overview of the economy and its future prospects. I will discuss two of the Federal Reserve System's lending programs – which are being operated by the Boston Fed for the System – in an effort to help explain and illuminate recent policy actions and to inform businesses and lending institutions about how they can participate.

The first emergency lending facility I will discuss is the Money Market Mutual Fund Lending Facility,[3] which was established in late March and operates out of the Boston Fed to help alleviate disruptions in short-term credit markets and money market mutual funds.

The second program I will discuss is the Main Street Lending Program, which, when it begins operating in the coming weeks, is intended to help provide loans to businesses affected by the COVID-19 pandemic.[4] The program will operate through three facilities: the *New*, *Priority*, and *Expanded* loan facilities. I will say more about the program in a moment.

Recent Economic Developments

I'd like to give an overview of recent economic developments. As I noted in my introduction, the April employment report encapsulated the scale and severity of this public-health-driven economic crisis. Job loss for so many Americans is spurring the Federal Reserve to do all we can to help, as I will describe shortly.

While the economy had a very low unemployment rate in February – 3.5 percent – by April the unemployment rate had soared to 14.7 percent, as shown in **Figure 1**. In addition, payroll employment declined by 20.5 million jobs in the month of April. This unprecedented shock to the labor markets has two components: employees who *temporarily* are not working because of the mandated shutdowns intended to contain the pandemic, and those workers currently, or likely to soon be, more *permanently* unemployed because firms are closing or because the weakened demand for goods does not require as many workers. Unlike the past three recessions, the April data are consistent with most of these workers being temporarily laid off. Yet the following is a key point: how we all address the pandemic will greatly influence how many of these temporary job losses become permanent.

Figure 2 shows the percent decline in payroll jobs for select industries, with the decline measured from February, before the pandemic widely affected labor markets. The largest declines occurred in industries where social distancing is most challenging – such as recreation, entertainment, the arts, and food services. These activities have been severely curtailed by closure requirements, and may continue to be hurt by the discomfort individuals may have in attending large events or eating out while community spread of the disease remains a concern.

Figure 3 illustrates the declines in employment in terms of the *total* numbers of jobs lost by industry. The two largest drops were in accommodation and food services, and retail trade. These two industries employ a large share of U.S. workers, and again are industries that may have trouble returning to full capacity as long as consumers are concerned about their safety.

Figure 4 shows the share of total employment for industries that may be significantly impacted by the pandemic for some time. With accommodation and food services, and retail trade, together accounting for such a large share of total employment (nearly 20%), a full recovery in the economy is going to hinge on how well society gets the pandemic under control.

If consumers are afraid to eat out, shop, or travel, a relaxation in laws requiring business closures may do little to bring back customers, and thus jobs.

Figure 5 provides another reason why firms may face significant challenges as long as the public health concerns have not been sufficiently mitigated. Americans that are between 50 and 79 years of age account for 45 to 55 percent of purchases in spending categories that are importantly affected by social distancing. Because people in this age cohort are more likely to suffer severe consequences if infected by the virus, they may be particularly reluctant to venture out until the public health situation improves significantly.

In sum, simply allowing businesses to reopen is not a panacea. Until community spread of the virus has been significantly reduced, many of the industries with the sharpest job cuts will likely face reduced demand as long as social distancing is necessary. Public health solutions are paramount – without them, it will be virtually impossible to return to full employment. 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.

The Federal Reserve's Response to the Pandemic

If they do the right things, central banks can help address crises and prevent, or at least substantially mitigate, the spillover of problems from the financial realm to the real economy composed of household and business activity. Although the unemployment rates may look similar to those in the Great Depression, both fiscal policy from the federal government and Federal Reserve actions have now – in contrast to the Great Depression era – taken unprecedented actions to mitigate the economic downturn. The Fed quickly reduced short-term interest rates to close to zero; stabilized the foundational markets for Treasury and mortgage securities, through purchases; and established lending facilities to make sure that credit is available and not seizing up. And Congress has passed and the President has signed several aggressive spending and aid packages to assist laid-off workers and to support businesses during the shutdown.

Today, in the interest of time, I would like to focus on two of the emergency Federal Reserve facilities, as they are being administered by the Federal Reserve Bank of Boston. It is important to note that the powers granted to the Fed for emergency and exigent actions involve *lending, not spending*.[5] All of the Fed's programs involve loans that are to be repaid; they are not grants by the Fed. But lending can play a crucial role in a crisis and in bridging to more normal conditions.

The Money Market Mutual Fund Liquidity Facility, or MMLF, set up in March and operating through the Boston Fed, was designed to address two problems. First, short-term debt instruments, such as commercial paper, were not trading efficiently due to a lack of liquidity, and the interest-rate spreads had become unusually wide (meaning rates were jumping higher as asset prices fell in "fire sale" mode). Second, prime money market funds that buy these short-term debt instruments were facing redemptions by investors, and at the same time were having difficulty selling financial instruments that normally are highly liquid, with rates close to the federal funds rate.

More specifically, money market funds that invest substantially in corporate short-term debt, including commercial paper, experienced large redemptions as conditions deteriorated in

March. The concern was that such large redemptions would reduce the supply of credit to businesses. Moreover, these large outflows risked further disrupting the short-term credit markets, including if money market mutual funds resorted to disposing of assets at "fire sale" prices, or imposed fees or gates on redeeming investors – which would mean further loss of public confidence and impacts on households and businesses that invest in these funds.

Figure 6 shows that in February, commercial paper was trading relatively close to the federal funds rate. As the pandemic worsened, the federal funds rate was cut to nearly zero, but even so, rates on commercial paper rose significantly. In response to these developments, the MMLF was established to provide non-recourse loans, generally at an interest rate of 1.25 percent, that were collateralized by short-term debt instruments owned by money market funds. As the MMLF made loans, the rates began to fall on short-term debt instruments, and by the middle of April, short-term rates were well below the 1.25 percent charged on those loans, meaning the market had stabilized and the emergency facility worked.

Figure 7 shows another dimension of this brief crisis. While government money market funds, which invest in securities with little default risk, were experiencing large inflows, by the middle of March as crisis conditions flared up, the riskier prime money market funds were experiencing significant outflows. To meet these outflows, the prime funds were selling short-term debt instruments amid an illiquid market for such assets. With the availability of the MMLF, the pressure on prime funds receded and investor confidence improved so that the outflows quickly slowed down – and since the middle of April both types of funds have been generally experiencing inflows.

Figure 8 shows that assets under management of the government money market funds have continued to rise, and are well above pre-pandemic levels. Prime funds have stabilized and are gradually seeing modest inflows, although they remain well below pre-pandemic levels. Since the middle of April, there has been little activity at the MMLF. This is by design: the facility's terms become less attractive as the crisis in a particular market fades and normal credit flows resume. The facility has advanced more than $50 billion in loans, which are already in the process of being paid off, with total loans outstanding now under $40 billion. Currently, both short-term credit markets and money market funds are operating with more normal pricing and interest-rate spreads. This is important, as these markets underpin the financing flows on which many businesses depend.

Main Street Lending Program

The other Federal Reserve program being administered by the Boston Fed is the Main Street Lending Program. The MSLP is a loan program designed to help credit flow to small- and medium-sized businesses that were in good financial condition prior to the crisis, but now need loans that can help them until they have recovered from, or adapted to, the impact of the pandemic.

Its structure is designed to reach those borrowers in a way that supports their operations and employment, supporting economic activity but also managing risk and safeguarding the taxpayer backstop. There are various loan sizes to meet a range of needs of small and midsize borrowers, and attractive terms (for example, no payments or interest for a year, a 4-year term, and a moderate interest rate).

Let me begin by discussing some of the ways this program is unique, even among the Fed's other crisis actions, both now and in the past. By the way, some of these unique aspects account for the time it is taking to set up the program. While many of the Fed's facilities focus on securities that are relatively homogenous financial instruments, this program seeks to support bank lending. Bank loans are not very standardized – for example, the terms and conditions of the loan are negotiated between borrower and lender. Smaller companies likely also have less public information available for making a credit risk evaluation.

The program differs from other programs for businesses made possible by the CARES Act. Unlike the Paycheck Protection Program (PPP), where many loans could turn to grants funded by the CARES Act, the Main Street Lending Program involves loans that must be repaid. The MSLP has no loan guarantee like the Small Business Administration provided for the PPP, and requires both the borrower and lender to be eligible to participate in the program.[6]

Figure 9 shows a stylized version of the Main Street program. As previously mentioned, the program is designed to serve businesses that were doing well before the pandemic began, are experiencing pandemic-related disruption, and are expecting to do well once the pandemic is contained. The program is aimed at lending to mid-sized and small entities that are too big for the PPP and too small for other emergency credit facilities.[7] Enterprises of this sort accounted for a major share of U.S employment, and this program intends to make loans that support their ability to continue until the pandemic is contained and the recovery ensues.

Businesses will not come directly to the Federal Reserve for a loan. Instead, potential business borrowers need to work with an eligible lender to determine if they meet the minimum requirements for the program, as defined in the term sheets as well as the lender's own underwriting standards. An eligible lender will ultimately determine whether a borrower is approved for a loan, considering credit risk. Banks will underwrite the loan and the Federal Reserve will participate with the bank in the lending by purchasing 85 or 95 percent of the loan, depending on the program facility. Hence, the lenders continue to have "skin in the game" to ensure that they will be motivated to certify the quality of the loan.

Some of the high-level terms of the loans are shown in **Figure 10**. The new, priority, and expanded facilities' loans all share some common characteristics. The maturity of the loans is four years, the loans have no interest or principal payments due in the first year, the loans can be prepaid, and the loans have an interest rate of LIBOR plus 3 percent.

However, there are differences among the facilities, including with respect to how the loan types interact with the borrower's existing outstanding debt. The new and priority lending facilities, which are likely to serve somewhat smaller companies, provide new loans for which the eligible lender seeks the participation of the Federal Reserve. Both facilities would be available to the participating lender's existing customers as well as new customers. The loan size range is $500,000 to $25 million. The two facilities have different features to allow a broader range of potential eligible borrowers. In the *new* facility, the MSNLF, the lender retains a 5 percent stake, but the debt level of the borrower must remain low.[8] In the *priority* facility, the MSPLF, the borrowing business can carry somewhat more debt but the lender must take a larger share of the loan – 15 percent – and the loan must not be junior to[9] other debt (other than mortgage debt).[10]

For larger businesses, it is likely that they may already have a loan agreement with multiple banks, with these loans being secured or unsecured. The Main Street program's *expanded* loan facility (MSELF) provides an opportunity for eligible lenders to increase (or "upsize") an existing term loan or revolving credit facility, with the Federal Reserve becoming a new participant. This expanded loan facility for larger borrowers has a much higher minimum loan size, $10 million, and a maximum loan size of $200 million. The bank must maintain a 5 percent stake in the expanded loan, with the Federal Reserve taking the remainder.

As shown in **Figure 11**, there are several ways the Federal Reserve will manage this program to address inherent risks. First, the lenders will need to underwrite the loan and retain their own stake in it, at 5 or 15 percent depending on the facility. Second, the borrower's credit needed to be in good standing prior to the pandemic – loans to these borrowers must have been rated "pass" at the end of 2019.[11] Third, the borrower is limited in how levered the loan can be, as noted a moment ago. One implication is that firms that were already very highly levered going into the pandemic will not qualify for a loan from these facilities. Fourth, and more broadly, the U.S. Treasury Department will make a $75 billion equity investment in the facilities to cover potential losses, using funds appropriated under the CARES Act.

This is only a high-level discussion of the program. Interested borrowers or lenders should refer to the information we have posted on the web, for more program details. Additional details about the program will be forthcoming as we approach launch, including webinars available to potential borrowers and to lenders.

Also, I would mention that while nonprofit organizations are not currently eligible under the program, the Federal Reserve acknowledges the unique needs of nonprofit organizations, many of which are on the front lines providing critical services and research to fight the pandemic. The Federal Reserve and the Treasury Department will be evaluating the feasibility of adjusting the borrower eligibility criteria and loan eligibility metrics of the program for such organizations. Such an evaluation will also likely take place with respect to asset-based borrowers.

The maximum amount of loan participation agreements the Fed will purchase in the Main Street program is $600 billion, with the U.S. Treasury providing $75 billion in equity to cover potential losses. Since these are loans with repayment expected (not forgivable loans or grants), we are anticipating that the Treasury backstop will ensure that there is sufficient capacity to meet all eligible loans. The Federal Reserve Bank of Boston is in the process of hiring several companies to help support this large and complex program. Information on these supporting firms – selected in a competitive process focused on both capacity to perform and price – will be posted on the Boston Fed's website in the coming weeks.

This is an important program, and we've worked very hard to get it right. We listened carefully to initial feedback and expanded the program in a number of ways to serve a wider range of borrowers. It will not be able to assist everyone, but we expect that it will provide an important bridge for many businesses that employ much of the American workforce. We will also have the ability to adjust the program, if needed.

As **Figure 12** shows, businesses and lenders interested in participating can find more information at www.bostonfed.org/mslp -- including frequently asked questions, term sheets, a mailbox for submitting questions, and a way to subscribe to future email notifications that will go out when updates are available. I would also mention the webinars that we plan to host over the coming weeks.

Concluding Observations

The economy has suffered a truly severe shock from the COVID-19 public health crisis. The unemployment rate has risen very significantly in response to necessary shutdowns intending to limit the health impact of the pandemic. However, even when businesses are free to open, many may face diminished demand until customers once again feel secure leaving their homes, which underlines that public health is at the root of this crisis and its solutions.

I expect that the unemployment rate will likely peak at close to 20 percent. Unfortunately, even by the end of the year, I expect the unemployment rate to remain at double-digit levels. This outlook is both sobering and a call to action. Now is the time for both monetary and fiscal policy to act boldly to minimize the economic pain from the pandemic.

The Federal Reserve has taken strong actions to mitigate the economic consequences of this crisis. Policymakers have dropped interest rates to near zero, bought Treasury and mortgage-backed securities, and initiated a range of lending facilities. I have provided some detail on the Main Street Lending Program, one of the more innovative and economically important programs which we expect to open in the coming weeks. As Fed policymakers, we will continue to vigilantly pursue ways to help the economy return to full employment.

Thank you for having me today. I wish you continued health during these challenging times.

[1] See May 8, 2020 Employment Situation Summary by the U.S. Bureau of Labor Statistics.

[2] For more discussion, see Chair Powell's April 29, 2020 FOMC press conference transcript: https://www.federalreserve.gov/mediacenter/files/FOMCpresconf20200429.pdf.

[3] For more about the Money Market Mutual Fund Liquidity Facility that was established on March 18, 2020, see: https://www.federalreserve.gov/monetarypolicy/mmlf.htm.

[4] For more about the Main Street Lending Program that will be operated by the Federal Reserve Bank of Boston, see https://www.federalreserve.gov/monetarypolicy/mainstreetlending.htm.

[5] For more about the lending powers of the Federal Reserve, see Section 13(3) of the Federal Reserve Act: https://www.federalreserve.gov/aboutthefed/section13.htm.

[6] I would also note that to address the needs of businesses larger than PPP or MSLP can address, the Fed established the Primary Market Corporate Credit Facility, to provide large firms the ability to directly issue securities to the Federal Reserve. See https://www.federalreserve.gov/monetarypolicy/pmccf.htm.

[7] For a list of the Fed's funding, credit, liquidity, and loan facilities, see: https://www.federalreserve.gov/funding-credit-liquidity-and-loan-facilities.htm.

[8] The loans must not be contractually subordinated in terms of priority to the borrower's other debt. For these loans, the adjusted debt to EBITDA ratio (a measure of income meant to capture the firm's ability to pay the debt) after taking the loan cannot exceed four.

[9] Must be senior to or *pari passu* with.

[10] The ratio of debt to adjusted 2019 EBITDA, after taking the loan cannot exceed six.

[11] Generally speaking, a "pass" rating is given if the borrower is performing as agreed, and repayment is expected in the normal course.