Breckinridge CAPITAL ADVISORS

PERSPECTIVES

SUMMARY: FISCAL STIMULUS AND MONETARY POLICY RESPONSES TO COVID-19

Through May 8, 2020, Congress passed four pieces of legislation in response to circumstances related to COVID-19. In addition, the Federal Reserve (the Fed) initiated monetary policies and programs to support market functions. The actions and some implications are summarized here in chronological order for reference. The summary includes analysis from members of the Breckinridge investment team of the implications for the municipal bond and corporate bonds markets. Fed specific programs and updates as of Friday, May 1 also are included.

CONGRESSIONAL ACTS

March 6, 2020 (enacted): The Coronavirus Preparedness and Response Supplemental Appropriations Act, 2020 (H.R. 6074), providing emergency supplemental appropriations of $8.3 billion to combat the spread of COVID-19 and counter the coronavirus pandemic in the U.S. Specifically targeted were research and development of vaccines as well as therapeutics and diagnostics, public health funding, medical supplies, health care preparedness, Community Health Centers and medical surge capacity, and combatting COVID-19 internationally.

March 13, 2020: President Donald Trump declared a national emergency, freeing up $50 billion in federal resources to combat COVID-19.

March 18, 2020 (enacted): The Families First Coronavirus Response Act (H.R. 6201), addressing the economic impact through $104 billion for efforts including temporarily increasing Medicaid reimbursement rates to states, free coronavirus testing, more funding for the Supplemental Nutrition Assistance Program, and paid family sick leave (financed via employer tax credits), among other efforts.

March 27, 2020 (enacted): Coronavirus Aid, Relief, and Economic Security Act (CARES Act) (H.R. 748), providing approximately $2 trillion in fiscal support to sectors across the economy. The CARES Act provided funding for healthcare, relief to businesses and organizations and a series of loans programs including the Main Street Business Lending Program (MSBLP), the Paycheck Protection Program (PPP), expanded Small Business Administration Economic Injury Disaster Loans , and provided the Secretary of the Treasury with the authority to make loans or loan guarantees to states, municipalities, and eligible businesses.

The CARES Act also funded tax credits, tax deferrals, and tax deductions for corporations and individuals, expanded unemployment benefits, student grants, student loans, and work-study programs, suspended some rules around retirement savings plan distributions, withdrawals and loans and health savings account reimbursements. It relaxed Medicare rules related to telehealth services and refills, and credit reporting related to COVID-19 payment deferrals. The Act also allowed Department of Defense contractors to use their federal contracts to pay its employees and subcontractors up to 40 hours per week per worker while the worker can neither work on-site nor work remotely on a contract through September 30, 2020.

- For the municipal bond market: By our calculations, the CARES Act as passed includes about $352 billion for municipal issuers. It also includes a loan fund with $454 billion through the Federal Reserve for the purpose of creating liquidity in the capital markets. Municipal issuers are eligible for the loans. In addition to the direct aid provisions, we believe that emergency relief for individuals and businesses are a significant credit positive for many municipals. Direct payments to families are likely to flow to essential items like property taxes, mortgage payments, and utility bills, in turn helping to stabilize the local general obligation, water-sewer, and electric revenue sectors, among others. Likewise, loans to small business should help limit the degree to which income and sales taxes might decline in their absence.

- For the corporate bond market: The portion of aid earmarked for corporations is $500 billion. Of that, $25 billion is carved out for airlines and $17 billion for businesses deemed critical for maintaining national security, which may include defense firms.

Of the remaining $458 billion, loans will be made to eligible businesses through facilities as established by the Fed. The Act also authorizes over $375 billion in small business loans which could be forgiven if the business maintains payroll and other expense payments. We would note that the fiscal stimulus may be more geared and helpful for businesses with weaker access to capital such as speculative grade issuers and small to mid-size enterprise (SMEs). The provisions within the Act may be viewed as too restrictive by investment grade (IG) issuers with regards to employment levels and prohibitions on stock buybacks if they are able to tap the market for liquidity.

April 24, 2020: The Paycheck Protection Program and Health Care Enhancement Act (H.R. 226), providing about $484 billion in relief to small business (increased PPP funding), hospitals and health care workers.

FED PROGRAMS

In addition to its zero lower bound (ZLB) interest rate and QE announcements, the Fed on **March 15** also announced that it would encourage use of the discount window by lowering the primary credit rate 150 basis points to encourage a more active use of the window, offer added flexibility in bank capital requirements to support lending to households and businesses, and coordinated with other central banks international (the Bank of Canada, the Bank of England, the Bank of Japan, the European Central Bank, and the Swiss National Bank) to lower pricing on U.S. dollar liquidity swap arrangements.

On **March 17**, the Fed announced creation of a Commercial Paper Funding Facility (CPFF) and creation of a Primary Dealer Credit Facility (PDCF). The CPFF is to buy corporate paper from issuers who otherwise might have difficulty accessing the short-term debt market. The Department of the Treasury is to provide $10 billion of credit protection to the Fed for the CPFF from the Treasury's Exchange Stabilization Fund (ESF). The PDCF is offering collateralized loans to large broker-dealers. The Fed is accepting a range of permissible capital, including corporate paper, to encourage participation in the corporate paper market, and the market more generally.

On **March 18**, the Fed announced creation of a Money Market Mutual Fund Liquidity Facility (MMLF) to offer collateralized loans to large banks that buy assets from money market mutual funds. It will accept capital, including corporate paper, to encourage participation in the money market mutual fund market in addition to the broader market.

On **March 19**, extended its cooperation with other central banks to include to the Reserve Bank of Australia, the Banco Central do Brasil, the Danmarks Nationalbank (Denmark), the Bank of Korea, the Banco de Mexico, the Norges Bank (Norway), the Reserve Bank of New Zealand, the Monetary Authority of Singapore, and the Sveriges Riksbank (Sweden).

On **March 20**, the Fed, in coordination with other central banks, increased the frequency of efforts to improve the liquidity of U.S. dollar swaps from weekly to daily. In addition, the Fed, in co-ordination with the Federal Reserve Bank of Boston, expanded the list of acceptable collateral under the MMLF to include high-quality municipal debt.

On **March 23**, the Fed announced a series of measures employing a wide range of the monetary policy authorities available to it, all with the aim to "support smooth market functioning". They included:

- Expanded QE to include purchases of commercial mortgage-backed securities
- Three new emergency lending facilities, a Primary Market Corporate Credit Facility (PMCCF) and a Secondary Market Corporate Credit Facility (SMCCF) to support credit to large employers, and a revival of the Term Asset-Backed Securities Loan Facility (TALF) to provide liquidity for outstanding corporate bonds. The three programs support up to $300 billion in new financing options for firms, backed by the Treasury Department's ESF which will provide $30 billion in equity to these facilities.
- Expanded the powers of two existing programs, the CPFF and PDCF. The MMLF now includes municipal variable rate demand notes and bank certificates of deposit. The CPFF now considers high-quality, tax-exempt commercial paper as eligible securities.
- Announced a technical rule change that amends the implementation of a rule impacting banks' requirements to maintain total loss absorbing capacity (TLAC).

On **March 24**, the Fed announced a six-month delay of implementation of the Foreign Banking Organization Maximum Daily Overdraft Rule to ease operating restrictions on foreign banking organizations, and scaled back non-critical oversight of the financial institutions it regulates, with the impact most felt at smaller firms.

On **March 26**, the Fed announced reporting relief for small financial institutions of less than $5 billion in total assets that submit financial statements after filing deadlines. In addition, the New York Federal Reserve announced that it would begin purchasing securities backed by commercial mortgages for the first time. The purchases included immediate purchase of $1 billion fixed-rate Fannie Mae Delegated Underwriting and Servicing pools, with a 10-year loan term, with a further $3 billion to be purchased the following week. The securities would primarily be backed by multifamily housing blocks, such as apartment buildings, but that this effort may be expanded to cover other commercial mortgages.

On **March 30**, the Fed, in coordination with the Federal Deposit Insurance Corporation and the Office of the Comptroller of the Currency, announced actions designed to promote bank lending. First, banks may now adopt early a new methodology for measuring counterparty risk. Second, the agencies have released an interim final rule concerning the calculation of "current expected credit loss."

On **March 31**, the Fed postponed by six months a new framework by which it determines what constitutes control or ownership within a bank organizational hierarchy. In addition, the Fed established a new temporary repurchase facility (FIMA Repo Facility) for six months allowing foreign banks to exchange Treasury securities – temporarily – for U.S. dollars via repurchase agreement to increase U.S. dollar availability.

On **April 1**, the Fed loosened the supplementary leverage ratio, a secondary capital ratio that applies only to banks holding more than $250 million in consolidated assets to free up capital for lenders while prohibiting any other use of the additional funds.

On **April 6**, the Fed Implemented the CARES Act Community Bank Capital Ratio, a provision decreasing the regulatory burden on banks with the intention of freeing capital that can then be made available to businesses. It is a temporary measure, with the community bank leverage ratio returning to 9 percent by 2022. The Fed also announced three new emergency lending facilities provided for under the CARES Act and support the work of Treasury and the Small Business Administration (SBA). They include:

- A new emergency lending facility, the Paycheck Protection Program Liquidity Facility (PPPFL), that will purchase Payment Protection Program (PPP) loans from lenders, freeing those banks to continue lending under the PPP and removing those non-performing loans from the balance sheets of private industry
- A new emergency lending facility, the Main Street Business Lending Program (MSBLP), that will purchase $600 billion of debt from companies employing up to 10,000 workers or with revenues of less than $2.5 billion, with any required payments on these loans deferred a year
- A new emergency lending facility, the Municipal Liquidity Facility (MLF), that will purchase $500 billion of debt from states and cities with populations over 1 million; and
- Expanded scope for three existing facilities, the PMCCF, CMCCF, and TALF. These programs will now support up to $850 billion in credit. In addition, the Fed has expanded the list of eligible assets for participation in the TALF program.

On **April 23**, the Fed committed to releasing monthly details on the participants in and relief provided by some of the Fed's emergency lending facilities. The Fed also increased availability of intraday credit by suspending uncollateralized intraday credit limits and waiving some overdraft fees for program participants. Additionally, the Fed announced expanded access to the PPPLF to additional lenders, specific ally non-depository lenders including community development financial institutions, in anticipation of a fourth Congressional relief bill to authorize additional PPP funds.

On **April 24**, the Fed, in reporting to Congress details of emergency lending provided under the Section 13(3) emergency lending programs, the Fed confirmed that it provided at least $85 billion in funding via three of its programs: $51 billion in outstanding loans under the MMLF, $34.5 billion under the PDCF, and $249 million under the CPFF.

On **April 27**, Fed expanded access to the MLF, making the facility available to counties with a population of at least 500,000 and cities with a population of at least 250,000, up from previous requirements of 2 million for counties and 1 million for cities. The Fed also announced modifications to the program such that loan notes of 36 months – up from 24 – will now be accepted and extended the duration of the program to December 31, 2020.

On **April 30**, the Fed Expanded the MSBLP to eligible businesses with no greater than 15,000 employees and $5 billion in revenue and lowered the minimum loan size from $1 million to $500,000. Banks will now retain a higher percentage of some loans, ranging between 5 and 15 percent depending on loan type, with the Fed purchasing the remainder. The Fed did not indicate that the size of the program would change (with the Fed previously noting that it intended to purchase $600 billion of debt) but did indicate that Treasury will provide $75 billion for this program under the CARES Act.