



December 2020

FEDERAL RESERVE LENDING PROGRAMS

Use of CARES Act-
Supported Programs
Has Been Limited and
Flow of Credit Has
Generally Improved

GAO Highlights

Highlights of [GAO-21-180](#), a report to congressional committees

Why GAO Did This Study

The COVID-19 pandemic has resulted in substantial damage to the economy. The CARES Act, enacted as part of the federal response, includes amounts appropriated to Treasury and made available to provide loans, loan guarantees, and investments to states, tribes, municipalities, and eligible businesses. Section 4003(b)(4) of the act made available up to \$454 billion and potentially certain other amounts for Treasury to support Federal Reserve lending facilities in providing liquidity to the financial system that provides credit to these entities.

The CARES Act also included a provision for GAO to periodically report on these loans, loan guarantees, and investments. This report examines the level of participation in the facilities and what available evidence suggests regarding the effects of the facilities on corporate credit and related markets, states and municipalities, and small businesses; and the status of CARES Act funding available to support the Federal Reserve's facilities, among other things.

GAO reviewed applicable laws and agency documentation, and analyzed agency and other relevant data on the facilities and credit markets. GAO also interviewed Federal Reserve and Treasury officials and representatives from industry associations representing businesses, banks, and state and local governments.

View [GAO-21-180](#). For more information, contact Michael E. Clements at (202) 512-8678 or clements@ga.gov.

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Use of CARES Act-Supported Programs Has Been Limited and Flow of Credit Has Generally Improved

What GAO Found

The Board of Governors of the Federal Reserve System (Federal Reserve) authorized 13 lending programs—known as facilities—to ensure the flow of credit to various parts of the economy affected by the COVID-19 pandemic. Nine of the 13 facilities are supported through Department of the Treasury (Treasury) funding appropriated under the CARES Act. Overall, use of these CARES Act-supported facilities has been relatively limited. As of November 15, 2020, the CARES Act facilities had used about \$24 billion, or a little more than 1 percent, of the \$1.95 trillion the Federal Reserve can back in transaction volume for these facilities. According to representatives from small business associations, banks, and state and local governments, the terms and conditions for some facilities are a deterrent for some potential participants. Further, some small businesses may prefer not to take on more debt. The Federal Reserve has continued to adjust some of the terms of its facilities, which are designed to function as backstops.

CARES Act-Supported Facilities' Transaction Volume and Capacity, as of November 15, 2020

Federal Reserve facility	Transaction volume (\$ in billions)	Transaction volume capacity (\$ in billions)	Percentage of transaction volume relative to capacity (%)
Primary and Secondary Market Corporate Credit Facilities	13.6	750	1.8
Main Street Lending Program (five facilities) ^a	5.0	600	<1
Municipal Liquidity Facility	1.7	500	<1
Term Asset-Backed Securities Loan Facility	3.9	100	3.9
Total	24.1^b	1,950	1.2

Source: GAO analysis of Board of Governors of the Federal Reserve System (Federal Reserve) documents and data. | GAO-21-180

^aThe Main Street Lending Program comprises five facilities: Main Street New Loan Facility, Main Street Priority Loan Facility, Main Street Expanded Loan Facility, Nonprofit Organization New Loan Facility, and Nonprofit Organization Expanded Loan Facility.

^bTransaction volumes do not sum to the total due to rounding.

Corporate and municipal credit markets, which are targeted by certain facilities, have improved since the onset of the pandemic. For example, from March through September 2020, companies nearly doubled the amount of corporate bonds issued compared to the same period in 2019. However, state and local governments and small businesses continue to face financial challenges.

As of November 15, 2020, Treasury had committed \$195 billion (of which it had disbursed \$102.5 billion) of the \$454 billion in CARES Act funds available to support the facilities. On November 19, 2020, the Treasury Secretary stated that his understanding of the congressional intent related to the facilities' authority to purchase new assets or make new loans was for all CARES Act facilities to stop purchasing eligible assets or extending credit on December 31, 2020. As such, the Secretary requested that the Federal Reserve return unused funds from facilities that received CARES Act funding. On November 20, 2020, the Federal Reserve stated it would work with Treasury to return unused CARES Act funds. GAO will continue to monitor facilities' use through the end of 2020, and the repayment of facilities' outstanding loans and investments.

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Abbreviations Page

COVID-19	Coronavirus Disease 2019
ESF	Exchange Stabilization Fund
Federal Reserve	Board of Governors of the Federal Reserve System
PPP	Paycheck Protection Program
RBOPS	Reserve Bank Operations and Payment Systems
SBA	Small Business Administration
SIFMA	Securities Industry and Financial Markets Association
Treasury	Department of the Treasury
VRDN	variable rate demand note

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December 10, 2020

Congressional Committees

The Coronavirus Disease 2019 (COVID-19) pandemic has resulted in substantial damage to the global economy and affected the stability of credit markets. The United States continues to experience serious economic repercussions and turmoil. For example, as of October 2020, there were 11 million unemployed individuals, compared to nearly 5.9 million individuals at the beginning of the calendar year.¹ In response to the economic crisis, in March 2020, Congress passed, and the President signed into law, the CARES Act, which provides over \$2 trillion in emergency assistance and health care response for individuals, families, and businesses affected by COVID-19.²

To provide economic relief, section 4003(b)(4) of the act made available up to \$454 billion and potentially certain other amounts for the Department of the Treasury (Treasury) to support the Board of Governors of the Federal Reserve System (Federal Reserve) in establishing emergency lending programs, known as facilities. These facilities are intended to provide liquidity to the financial system by lending to states, tribes, municipalities, and eligible businesses.³

The Federal Reserve has established nine facilities that are supported through Treasury's CARES Act-appropriated funds and are intended to support the flow of credit to employers, consumers, small and medium-sized businesses, state and local governments, and nonprofit organizations. The facilities are authorized under section 13(3) of the

¹Bureau of Labor Statistics, Unemployment Level (UNEMPLOY), retrieved from FRED, Federal Reserve Bank of St. Louis, accessed November 9, 2020, <https://fred.stlouisfed.org/series/UNEMPLOY>.

²Pub. L. No. 116-136, 134 Stat. 281 (2020).

³Section 4003(b) of the CARES Act authorized up to \$46 billion to support passenger and cargo air carriers and other eligible businesses, as well as businesses critical to maintaining national security. Any amount left from this \$46 billion in assistance will be available to support the Federal Reserve facilities for lending to eligible businesses, states, tribes, and municipalities. For purposes of our report, we did not include the \$46 billion portion in our review, as a separate GAO report will be reviewing assistance from this portion.

Federal Reserve Act and approved by the Secretary of the Treasury.⁴ In addition to these CARES Act facilities, the Federal Reserve also invoked its Section 13(3) authority to establish four emergency lending facilities that are not supported through Treasury's CARES Act-appropriated funds. These four facilities serve various markets and credit needs.

Section 4026(f) of the CARES Act contains a provision for us to review the loans, loan guarantees, and other investments provided under section 4003 of the act and report no later than 9 months after the date of enactment of the act, and annually thereafter through the year succeeding the last year for which loans, loan guarantees, or other investments made under section 4003 are outstanding. We extended our review to also include the Federal Reserve's lending facilities that are not supported by CARES Act section 4003 because they complete the Federal Reserve's full response to the pandemic using its Section 13(3) authority.

This report examines (1) steps the Federal Reserve and Treasury have taken to design, implement, monitor, and oversee lending facilities established in response to the COVID-19 pandemic; (2) what available evidence suggests regarding the effects of the Federal Reserve's facilities on corporate credit and related markets, and levels of participation in the facilities intended to support them; (3) what available evidence suggests regarding the effects of the Federal Reserve's facilities on states and municipalities, and levels of participation in the facility intended to support them; (4) what available evidence suggests about the effects of the Federal Reserve's facilities on small businesses, and levels of participation in the facilities intended to support them; and (5) the status of CARES Act funding available to support the Federal Reserve's facilities.

To address the first objective, we reviewed Federal Reserve and Treasury documentation on the design and implementation of the facilities, such as the term sheets, application documents, frequently asked questions, and publicly available announcements and press releases for each facility. We also reviewed the Federal Reserve's reports to Congress on the status, operations, and transaction amounts for each facility, as well as data on participants using the facilities. To examine the Federal Reserve's oversight and monitoring efforts, we reviewed the

⁴Section 13(3) of the Federal Reserve Act permits the Federal Reserve to provide emergency lending.

Federal Reserve's Division of Reserve Bank Operations and Payment Systems (RBOPS) documentation of its (1) framework and approach to oversight of the facilities, and (2) completed reviews of the facilities.

To address our second, third, and fourth objectives, we analyzed the most recently available data on indicators of credit markets affected by the facilities. To identify and select potential indicators, we reviewed prior and ongoing GAO work, federal regulatory agencies' reports and data, data available from the Bloomberg Terminal and the Securities Industry and Financial Markets Association (SIFMA), and data on small business owners from the National Federation of Independent Businesses. We took a number of steps to assess the reliability of the data sources and indicators, including reviewing relevant documentation, reviewing prior GAO work, and interviewing data providers. We found that, collectively, the indicators were sufficiently reliable for the purposes of providing a general sense of how credit markets are performing. We also reviewed relevant research publications from academics, regulatory agencies, and industry experts. To describe levels of participation and the transaction volume for specific Federal Reserve facilities, we obtained the total number of transactions and total dollar amounts from the Federal Reserve for the facilities.

To address our fifth objective, we reviewed Federal Reserve and Treasury documentation on CARES Act-appropriated amounts in support of the Federal Reserve's facilities, including amounts allocated to the facilities.

For all objectives, we interviewed Federal Reserve and Treasury officials, representatives from associations representing banks, small businesses, and municipalities, and representatives from a credit rating agency. We also reviewed relevant federal laws and regulations, and a relevant GAO report.⁵ See appendix I for more information on our scope and methodology.

We conducted this performance audit from March 2020 to December 2020 in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe

⁵See GAO, *Federal Reserve System: Opportunities Exist to Strengthen Policies and Processes for Managing Emergency Assistance*, [GAO-11-696](#) (Washington, D.C.: July 21, 2011).

that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives.

Background

Overview of the Federal Reserve System

The Federal Reserve Act established the Federal Reserve System as the country's central bank.⁶ The Federal Reserve System consists of three parts: the Federal Reserve Board, Reserve Banks, and the Federal Open Market Committee. The Federal Reserve Board is a federal agency located in Washington, D.C., which is responsible for maintaining the stability of financial markets; supervising financial, bank, and thrift holding companies, state-chartered banks that are members of the Federal Reserve System, and the U.S. operations of foreign banking organizations; establishing monetary policy; and providing general supervision over the operations of the Reserve Banks. The Federal Reserve System is divided into 12 districts. Each district is served by a regional Reserve Bank. The Federal Reserve Act authorizes the Reserve Banks to make discount window loans, in accordance with the rules and regulations prescribed by the Federal Reserve Board, and to execute open-market operations at the direction of the Federal Open Market Committee.⁷ The Reserve Banks also provide payment services, such as check clearing and wire transfers, to depository institutions, the Treasury, and government agencies. In addition, Reserve Banks provide cash services to financial institutions and serve as the Treasury's fiscal agent. RBOPS oversees the policies and operations of the Reserve Banks.

Overview of Federal Reserve Emergency Lending Authority

The Federal Reserve Board has the authority to authorize the Reserve Banks to extend credit more broadly than usual during emergencies. Reserve Banks typically lend to banks through discount window programs

⁶Federal Reserve Act, Pub. L. No. 63-43, 38 Stat. 251 (1913). The Federal Reserve System is self-funded and pays its expenses and maintains a statutorily limited amount of surplus from its revenue. Remaining revenue is transferred to the Treasury.

⁷The discount window is a Federal Reserve Board lending program that allows eligible institutions to borrow money, usually on a short-term basis, at an above market rate to meet temporary liquidity shortages. The Federal Open Market Committee consists of the seven members of the Board of Governors, the President of the Federal Reserve Bank of New York, and four other Reserve Bank presidents who serve on a rotating basis. The Committee is responsible for directing open market operations to influence the total amount of money and credit available in the economy. The Federal Reserve Bank of New York carries out the Committee's directives on open market operations by engaging in purchases or sales of certain securities, typically U.S. government securities, in the secondary market.

based on established statutory criteria.⁸ However, under Section 13(3) of the Federal Reserve Act, during unusual and exigent circumstances, the Federal Reserve can authorize Reserve Banks to extend credit to a broader range of borrowers.⁹

During the 2007–2009 financial crisis, the Federal Reserve invoked its Section 13(3) authority to create emergency programs to stabilize financial markets and avert the failures of a few individual institutions. Through these programs, the Federal Reserve extended credit to nonbank financial firms for the first time since the 1930s. The Federal Reserve used its Section 13(3) authority to create six broadly based facilities (see table 1) and provide direct assistance to four large financial firms. The Federal Reserve used special purpose vehicles to conduct some of the transactions. Special purpose vehicles are legal entities created to carry out a specific financial purpose or activity—for example, to borrow from a Reserve Bank to purchase financial assets.

Table 1: Federal Reserve Lending Facilities Established with Section 13(3) Authority during the 2007–2009 Financial Crisis

Name of facility	Date announced
Term Securities Lending Facility	Mar. 11, 2008
Primary Dealer Credit Facility	Mar. 16, 2008
Asset-Backed Commercial Paper Money Market Mutual Fund Liquidity Facility	Sept. 19, 2008
Commercial Paper Funding Facility	Oct. 7, 2008
Money Market Investor Funding Facility	Oct. 21, 2008
Term Asset-Backed Securities Loan Facility	Nov. 25, 2008

Source: Federal Reserve Board Statistical Release H.4.1 and Federal Reserve Board documents | GAO-21-180

In 2010, the Dodd-Frank Wall Street Reform and Consumer Protection Act added restrictions to the Federal Reserve’s Section 13(3) authority.¹⁰ The act required the Federal Reserve Board to implement any future emergency lending through facilities with broad-based eligibility, required that emergency lending assistance be for the purpose of providing liquidity to the financial system and not to aid a failing financial company, and required the approval of the Secretary of the Treasury for all lending

⁸12 U.S.C. § 347b(a).

⁹12 U.S.C. § 343(3).

¹⁰Pub. L. No. 111-203, § 1101, 121 Stat. 1376, 2113 (2010).

facilities. Additionally, the act required the Federal Reserve Board to promulgate a rule governing the use of Section 13(3) emergency lending authority. The Federal Reserve Board promulgated a final rule on December 18, 2015, amending Regulation A—which governs extensions of credit by Federal Reserve Banks—to include rules on the extension of emergency credit.¹¹

Treasury Exchange Stabilization Fund

The Exchange Stabilization Fund (ESF) is a fund that was originally established in the 1930s to stabilize the exchange value of the dollar by buying and selling foreign currencies and gold. The Secretary of the Treasury has broad authority to use the ESF to deal in gold, foreign exchange, and other instruments of credit and securities. Prior to 2008, Treasury primarily used the ESF to finance short-term loans to foreign countries facing a financial crisis. In 2008, Treasury used the ESF to guarantee deposits in money market mutual funds.

The ESF retains earnings from its operations and had a portfolio asset value of \$94 billion in February 2020. In March 2020, Treasury began using the ESF to make equity investments in Federal Reserve emergency lending facilities created in response to COVID-19. When the CARES Act was enacted later in the same month, it made available at least \$454 billion to the ESF for this purpose.

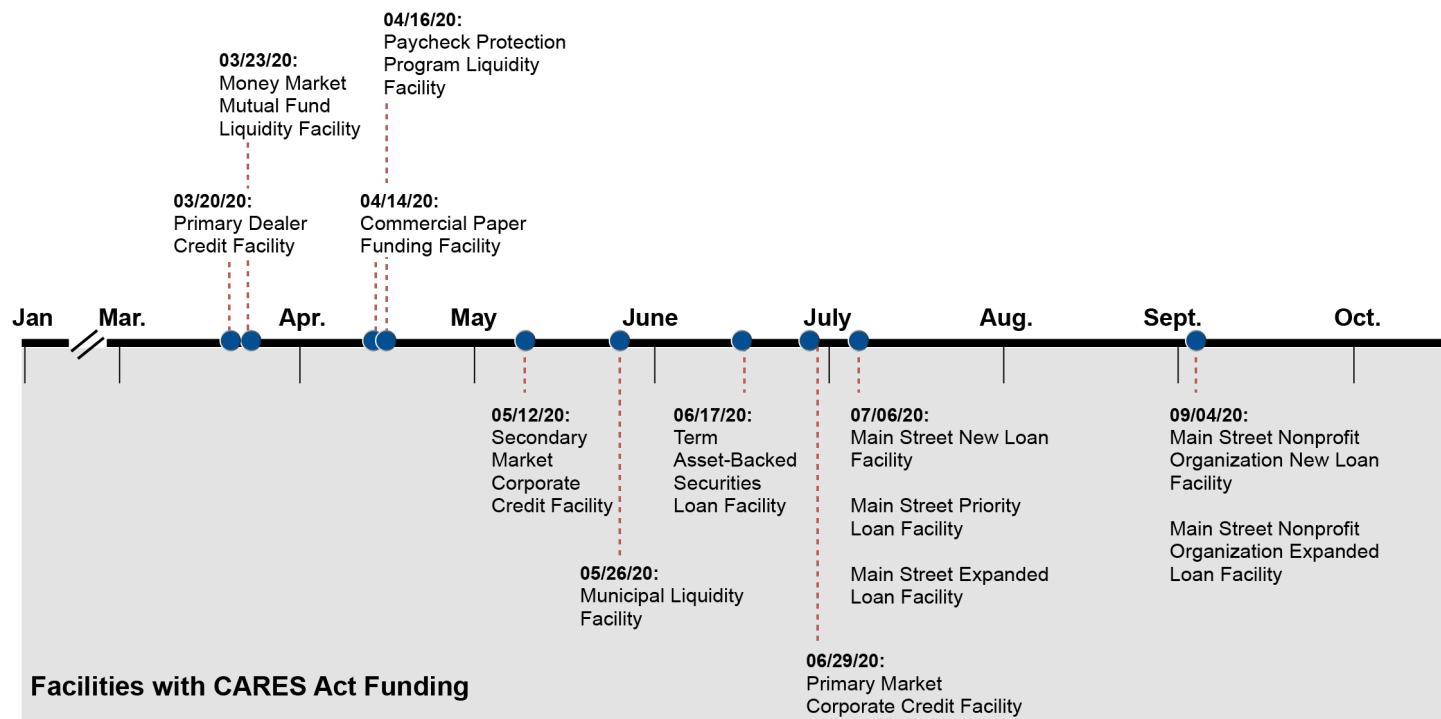
Federal Reserve Emergency Lending Facilities in Response to the COVID-19 Pandemic

From March through September 2020, the Federal Reserve used its authority under Section 13(3) to authorize 13 emergency lending facilities in response to the COVID-19 pandemic (see fig. 1). The Federal Reserve cited a number of factors in determining that unusual and exigent circumstances existed, including disruption in financial markets, reduced availability of credit, heightened need for credit, and an increase in business expenditures.

¹¹80 Fed. Reg. 78959, amending 12 C.F.R. Part 201 (Regulation A).

Figure 1: Federal Reserve Lending Facilities Implemented during the COVID-19 Pandemic

Facilities without CARES Act Funding



Source: GAO analysis of Federal Reserve documents and data. | GAO-21-180

Note: The dates in the timeline reflect the day when a facility can begin entering into transactions.

Nine of the 13 facilities receive support from funds appropriated to Treasury's ESF under the CARES Act and are subject to additional requirements (see table 2).¹² For example, facilities with CARES Act funding may only purchase obligations from or make loans to businesses that are created or organized in the United States and that have

¹²The Money Market Mutual Fund Liquidity Facility and the Commercial Paper Funding Facility received support from ESF funds before the enactment of the CARES Act and are not subject to CARES Act requirements.

significant operations and a majority of employees in the United States.¹³ Borrowers from the five Main Street facilities also are required to comply with additional CARES Act requirements, including limitations on executive compensation, dividends, and equity buybacks.¹⁴

In general, the CARES Act-supported facilities are designed to address broad sectors of the economy, such as large corporations, small and mid-sized businesses, and state and local governments. Of the nine CARES Act-supported facilities, eight were newly designed by the Federal Reserve and Treasury in response to the COVID-19 pandemic. Only the Term Asset-Backed Securities Loan Facility was previously used in the 2007–2009 financial crisis and reinstated as part of the Federal Reserve’s response to the COVID-19 pandemic. Overall, the CARES Act facilities can support up to \$1.95 trillion in transaction volume.

¹³Pub. L. No. 116-136, § 4003(c)(3)(C), 134 Stat. 281, 473 (2020). Further, under the CARES Act conflict-of-interest requirement, no covered entity may be eligible for any transaction with a facility with CARES Act funding. Pub. L. No. 116-136 § 4019, 134 Stat. 281, 485 (2020). The term “covered entity” means an entity “in which a covered individual directly or indirectly holds a controlling interest.” The term “covered individual” includes the president, vice president, the head of all executive branch departments (but not other federal agencies), and any member of Congress. The term also includes the spouse, child (including adult children), or son or daughter-in-law of such executive branch officials and members of Congress.

¹⁴Pub. L. No. 116-136, §§ 4003, 4004, 134 Stat. 281, 472, 476 (2020).

Table 2: Federal Reserve Lending Facilities with CARES Act Funding

Name of facility		Purpose	Facility activity	Announcement date	Starting activity date (all end Dec. 31, 2020)
1.	Primary Market Corporate Credit Facility	Support large businesses	Primary market facility: purchase qualifying bonds, and purchase portions of qualifying syndicated loans or bonds at issuance.	Mar. 23, 2020	June 29, 2020
2.	Secondary Market Corporate Credit Facility		Secondary market facility: purchase qualifying corporate bonds, certain bond portfolios, and U.S.-listed exchange-traded funds in the secondary market.	Mar. 23, 2020	May 12, 2020
3.	Main Street New Loan Facility	Support small and mid-sized businesses	New loan and priority loan facilities: purchase 95 percent participation interest in newly issued eligible loans that eligible lenders make to eligible small and mid-sized for-profit borrowers. Expanded loan facility: purchase 95 percent participation interest in a new extension of credit under an existing eligible loan made by an eligible lender to an eligible small or mid-sized for-profit borrower.	Apr. 9, 2020, for the new and expanded loan facilities supporting small and mid-sized for-profit businesses	July 6, 2020, for facilities supporting small and mid-sized for-profit businesses
4.	Main Street Expanded Loan Facility				
5.	Main Street Priority Loan Facility			Apr. 30, 2020, for the priority loan facility supporting small and mid-sized for-profit businesses	
6.	Main Street Nonprofit Organization New Loan Facility	Support small and mid-sized nonprofit organizations	Nonprofit new loan facility: purchase 95 percent participation interest in newly issued eligible loans that eligible lenders make to eligible nonprofit organization borrowers.	July 17, 2020, for facilities supporting nonprofit organizations	Sept. 4, 2020, for facilities supporting nonprofit organizations
7.	Main Street Nonprofit Organization Expanded Loan Facility		Nonprofit expanded loan facility: purchase 95 percent participation interest in a new extension of credit under an existing eligible loan made by an eligible lender to an eligible nonprofit organization borrowers.		
8.	Municipal Liquidity Facility	Support states and certain counties, cities, multistate entities, and revenue bond issuers	Purchase eligible notes directly from eligible issuers at time of issuance.	Apr. 9, 2020	May 26, 2020
9.	Term Asset-Backed Securities Loan Facility	Support consumers and businesses	Provide nonrecourse loans to U.S. companies secured by qualifying asset-backed securities generally backed by recently originated consumer and business loans.	Mar. 23, 2020	June 17, 2020

Source: GAO analysis of Federal Reserve Board documents. | GAO-21-180

Four of the 13 facilities authorized in response to the COVID-19 pandemic do not receive support from funds appropriated to Treasury's ESF under the CARES Act (see table 3). Of the four, the Commercial Paper Funding Facility, the Money Market Mutual Fund Liquidity Facility, and the Primary Dealer Credit Facility are facilities that the Federal Reserve used previously during the 2007–2009 crisis and reinstated in March and April of 2020. The Paycheck Protection Program Liquidity Facility was designed to supply liquidity to lenders that make Paycheck Protection Program (PPP) loans, and receives no funding from Treasury.

Table 3: Federal Reserve Lending Facilities without CARES Act Funding

Name of facility	Purpose	Facility activity	Announcement date	Activity dates (can be extended)
1. Commercial Paper Funding Facility	Serve as funding backstop to provide liquidity for U.S. issuers of commercial paper	Purchase commercial paper from eligible companies; eligible issuers include U.S. issuers of commercial paper, including municipal issuers and U.S. issuers with a foreign parent company	Mar. 17, 2020	Apr. 14, 2020, through Mar. 31, 2021
2. Money Market Mutual Fund Liquidity Facility	Assist money market mutual funds in meeting demands for redemption by investors	Make nonrecourse loans available to eligible financial institutions that are secured by high-quality assets purchased by the financial institution from money market mutual funds	Mar. 18, 2020	Mar. 23, 2020, through Mar. 31, 2021
3. Paycheck Protection Program Liquidity Facility	Facilitate lending by eligible institutions that provide loans to small businesses under the Paycheck Protection Program	Lend to institutions eligible for making Paycheck Protection Program loans on a nonrecourse basis, taking these loans as collateral	Apr. 9, 2020	Apr. 16, 2020, through Mar. 31, 2021
4. Primary Dealer Credit Facility	Provide support to primary dealers to facilitate the availability of credit to businesses and households	Provide loans to primary dealers in exchange for collateral	Mar. 17, 2020	Mar. 20, 2020, through Mar. 31, 2021

Source: GAO analysis of Federal Reserve Board documents. | GAO-21-180

Federal Reserve Analyzed Funding Needs and Feedback in Designing Its Facilities and Has Initiated Oversight Efforts

Emergency Lending Facilities Were Intended to Stabilize Financial Markets and Address Macroeconomic Issues

In designing and implementing the lending facilities, Federal Reserve officials said their primary goals were to stabilize financial markets and address macroeconomic issues, including meeting the needs of small and mid-sized businesses. To ensure the flow of credit and therefore stability in various financial markets, the Federal Reserve first reinstated some of the facilities established during the 2007–2009 financial crisis—the Commercial Paper Funding Facility, Money Market Mutual Fund Liquidity Facility, and Primary Dealer Credit Facility—that are not supported by CARES Act funding. Officials said that Federal Reserve staff were able to quickly reinstate these facilities because they already were familiar with them. To stabilize the corporate credit markets, the Federal Reserve also implemented two facilities that are supported through funding appropriated by the CARES Act—the Primary Market Corporate Credit Facility and Secondary Market Corporate Credit Facility.

To address macroeconomic issues caused by the pandemic, Federal Reserve officials said they considered macroeconomic factors, such as unemployment rates and the market segments accounting for the highest shares of U.S. employment, to design facilities to meet market needs. The facilities addressing macroeconomic issues include the Municipal Liquidity Facility, Term Asset-Backed Securities Loan Facility, and the five facilities under the Main Street Lending Program. All of these facilities are supported through funding appropriated by the CARES Act. The Federal Reserve also implemented the Paycheck Protection Program Liquidity Facility in support of the PPP, and that facility is not supported through CARES Act-appropriated funding.

Officials said that because most of the CARES Act-supported facilities are new and provide loans to nonfinancial companies, it took time for the Federal Reserve to structure and design the facilities to effectively address the needs of the targeted market segments. For example, the

Federal Reserve proposed three Main Street facilities for small and mid-sized for-profit businesses in April 2020—the facilities for new loans, expanded loans, and priority loans—but these facilities did not begin accepting loans until early July 2020. The Federal Reserve conducted two rounds of soliciting public comments on the facilities’ terms for participation—in April and June of 2020—and modified the terms as a result, which officials said contributed to the facilities not accepting loans until July.

Design of the Facilities

Intent. The Federal Reserve designed its emergency lending facilities to serve as a funding backstop—that is, as an alternative funding source for borrowers that are unable to readily obtain credit in the private market during economic downturns. Moreover, for the Main Street Lending Program, the Federal Reserve targeted these facilities to support lending to for-profit businesses and nonprofit organizations that were in sound financial health before the onset of the pandemic. In setting program terms and conditions, the Federal Reserve, in accordance with Regulation A, set rates at a level that was higher than what would be offered in the marketplace during normal market conditions but that would be effective in addressing market strains during crisis conditions.¹⁵ According to Federal Reserve officials, as designed, the facilities would experience limited participation when credit is available in the marketplace and increased participation when markets declined and there was a shortage of credit.

Terms. Federal Reserve officials told us that they set the facilities’ terms and eligibility requirements to balance each facility’s ability to meet market needs against managing potential credit exposures and minimizing losses to taxpayers.¹⁶ For example, based on our review of the Federal Reserve’s proposals for structuring the Main Street facilities serving small and mid-sized businesses, officials considered factors including how much loss a lender would retain if loans default, the size of eligible borrowers, the types of loans the facilities would purchase, and the facilities’ capacity for absorbing losses. For all of the facilities, the Federal Reserve published term sheets and frequently asked questions to

¹⁵12 C.F.R. § 201.4(d)(7).

¹⁶Section 13(3) of the Federal Reserve Act requires that the security for emergency loans be sufficient to protect taxpayers from losses. Section 13(3) also prohibits insolvent companies from participating in the loan facilities. Additionally, Section 4003 of the CARES Act prohibits forgiveness of loans extended to eligible businesses, states, tribes, or municipalities. To that end, Treasury’s equity investments in the facilities’ special purpose vehicles protect the Federal Reserve from future losses.

set out and clarify the terms, including eligibility requirements and restrictions, for participating in each of the facilities.

Treasury support. As part of the CARES Act facilities' design process, the Federal Reserve conducted scenario-based analyses in determining how the lending terms and eligibility requirements would affect the facilities' funding needs, including support from Treasury. For example, our review of the scenario-based analyses for the Municipal Liquidity Facility and Main Street facilities found that Federal Reserve staff set the agreed-upon level of Treasury funding to be sufficient to prevent these facilities, and ultimately the Federal Reserve, from incurring losses, even if the facilities reached their maximum capacity and experienced default rates higher than any previous historical comparison.

Lender underwriting. For loans under the Main Street program, as another layer to manage the Main Street facilities' risk exposure, lenders also apply their own underwriting standards as part of the loan approval process. Federal Reserve officials said that this allows lenders to tailor the loan approval to each borrower's unique situation and enables traditional underwriting practices to assess a borrower's creditworthiness. Federal Reserve officials told us that to ensure lender participation, they wanted to allow lenders to make loans based on standards that align with their underwriting practices. Officials also told us that lenders likely would be discouraged from participating in a facility if the Federal Reserve required them to make loans based on standards different from those typical of their underwriting process.

On September 18, 2020, the Federal Reserve updated its Main Street Lending facilities' frequently asked questions to clarify the Federal Reserve's and Treasury's expectations on lender underwriting. The agency emphasized that underwriting should assess a borrower's pre-pandemic financial condition and post-pandemic prospects in making loan approval decisions, in an effort to encourage greater lender participation in the program.

Feedback on the facilities. As previously mentioned, for the Main Street Lending facilities serving small and mid-sized businesses, the Federal Reserve also sought and considered public input in revising and expanding the facilities' terms in April and June 2020. For example, partly based on public comments, the Federal Reserve and Treasury lowered the minimum loan amount for certain loans from \$1 million to \$500,000 (in April), to \$250,000 (in June), and then to \$100,000 (in October). The Federal Reserve and Treasury also increased the loan repayment period

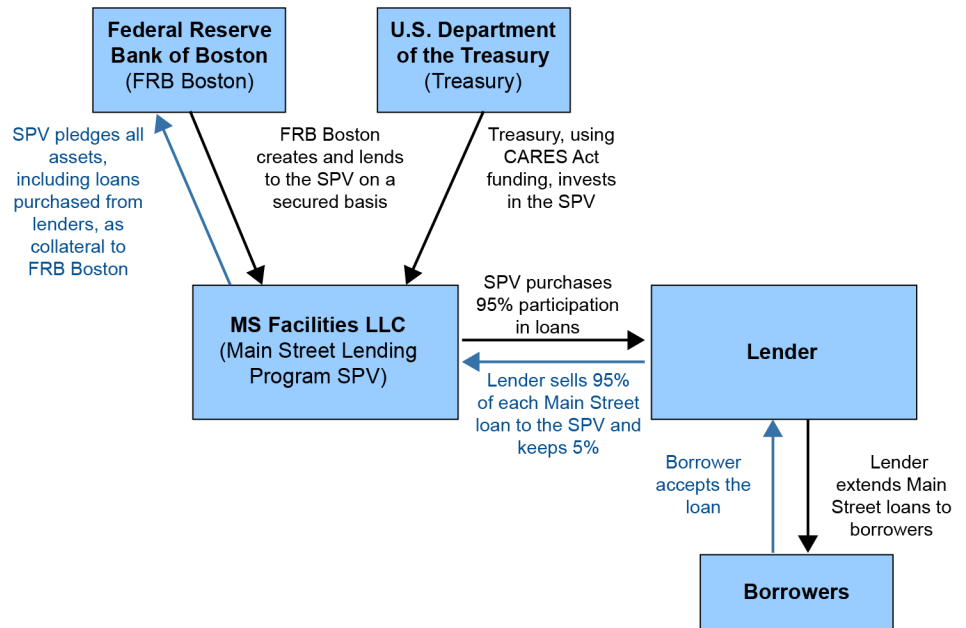
from 4 years to 5 years (in June) and raised the Federal Reserve's participation—the percent purchased of lenders' Main Street loans—from 85 percent for certain loans to 95 percent for all loans. For the Municipal Liquidity Facility, the Federal Reserve and Treasury also expanded the facility's scope and duration (in April) and the number and types of entities eligible to use the facility (in June).

Once facilities were operational, the Federal Reserve created mechanisms for collecting and addressing public feedback, including an email inbox. For example, for the Main Street program, Reserve Bank staff review emails daily and forward comments about program design and access to the Federal Reserve Board for review, according to documentation we reviewed on the Federal Reserve Bank of Boston's email procedures.

Federal Reserve and Treasury Collaboration

The Federal Reserve worked with Treasury to design and implement the facilities and obtain the Treasury Secretary's approval of them. According to Federal Reserve and Treasury officials, the Federal Reserve has primary responsibility for designing, implementing, and managing the facilities. Officials added that the Federal Reserve coordinated with Treasury through regular meetings and discussions on policy and legal issues as well as key details, including finalizing the size of Treasury's investments in the facilities and the terms and conditions for extending loans. For the facilities supported by CARES Act funding, Treasury provides support by making an equity investment in the special purpose vehicle that the Federal Reserve established to support a facility's operations. The investment covers losses that the facility may incur. As an example, figure 2 illustrates the lending structure of the Main Street Lending Program.

Figure 2: Funding Flow for Main Street Facilities Serving Small and Mid-Sized Businesses



SPV: special purpose vehicle

Source: GAO analysis of the Board of Governors of the Federal Reserve System and the Federal Reserve Bank of Boston information on the Main Street Lending Program. | GAO-21-180

Federal Reserve Actions to Address Operational Concerns with Previous Facilities

Inconsistent treatment of borrowers. In July 2011, we found that a few of the Federal Reserve’s 2007–2009 emergency lending programs lacked specific procedures for guiding how a lending Reserve Bank would exercise discretion for restricting program access for higher-risk borrowers, which we said could lead to inconsistent treatment of participants across lending programs.¹⁷ We therefore recommended that the Federal Reserve strengthen procedures in place to guide the Federal Reserve Banks’ efforts to manage program access by high-risk borrowers, and to ensure consistent treatment of participants across programs. Because the Federal Reserve implemented programs in response to the COVID-19 pandemic similar to those implemented in 2007–2009, this recommendation remains relevant today.

In our follow-up on this recommendation, we found that the Federal Reserve established eligibility requirements and terms for current facilities that could not vary by participant. As previously mentioned, for each of

¹⁷GAO-11-696.

the facilities the Federal Reserve established in response to the current pandemic, it published term sheets that set out the eligibility criteria for participants, restrictions, and other terms. According to Federal Reserve officials, the Reserve Banks establish and operate the facilities in accordance with the criteria stipulated in the term sheets and do not have discretion to operate or approve transactions that fall outside of the scope of the term sheets.

The Main Street Lending Program allows the Federal Reserve some discretion in determining the eligibility of an entity. However, the Federal Reserve's discretion applies only to determining whether an entity that does not fall within the Main Street Lending Program's definition of a "business" or a "nonprofit organization" may nonetheless be deemed a business or nonprofit organization.¹⁸ The Federal Reserve does not have discretion in waiving borrower eligibility requirements, so the entity still must meet those requirements. Because the Federal Reserve does not have discretion to waive borrowers' eligibility requirements, there is no risk of inconsistent treatment of program participants because all interested participants in a facility must meet the same terms and requirements for that facility. Therefore, the Federal Reserve's actions effectively address the intent of our 2011 recommendation that the Federal Reserve strengthen procedures pertaining to exercising discretion in managing program access for higher-risk borrowers.

Loss monitoring. In July 2011, we found that the Federal Reserve estimated and tracked potential stress losses under adverse economic scenarios for some facilities but not for others. As a result, the Federal Reserve Board and Reserve Banks did not have a comprehensive view of potential risk exposures when making risk management decisions.¹⁹ We recommended that the Federal Reserve document a plan for estimating

¹⁸The Main Street Lending Program defines "business" as an entity that is organized for profit as a partnership, a limited liability company, a corporation, an association, a trust, a cooperative, a joint venture with no more than 49 percent participation by foreign business entities, or a tribal business concern as defined in 15 U.S.C. § 657a(b)(2)(C)—with the term "small business concern" replaced with "business." The Federal Reserve has discretion to determine other entities are "businesses", and used such discretion on July 31, 2020, to find that tribal economic enterprises that do not have a separate legal personality from the related tribal government are "Businesses". See question E.2 of the *Main Street Lending Program – For-Profit Businesses Frequently Asked Questions*. The program also defines a "nonprofit organization" as a tax-exempt nonprofit or veterans' organization as described in Section 501(c) of the Internal Revenue Code, but the Federal Reserve is within its discretion to choose to include other forms of nonprofit organizations.

¹⁹[GAO-11-696](#).

and tracking losses that could occur under more adverse economic conditions within and across all emergency lending activities, and for using this information to inform policy decisions, such as decisions to limit risk exposures through program design or restrictions applied to eligible borrowing institutions. Because the Federal Reserve implemented similar facilities in response to the COVID-19 pandemic, this prior recommendation remains relevant.

As of October 2020, the Federal Reserve had taken some actions to address our recommendation. As previously mentioned, the Federal Reserve conducted scenario-based analyses as part of designing the facilities to assess the extent of possible losses in a range of scenarios—including severely adverse scenarios—and to determine the amount of Treasury’s funding necessary to support the facilities. As discussed in the next section, the Federal Reserve also monitors and reports on the facilities’ usage. Federal Reserve officials said that the Reserve Banks responsible for administering the facilities may hire vendors with expertise in modeling losses as further support for their risk monitoring. Further, for financial reporting purposes, the Reserve Banks estimate losses from loan defaults on an aggregated basis across the Federal Reserve System to determine allowances for loan and lease losses. However, information on the extent to which they have assessed risk monitoring on an aggregated, system-wide basis is presented in the Federal Reserve’s year-end financial statements, which were not released before this report. As such, we will continue to review the Federal Reserve’s actions taken to address this recommendation when additional documentation is available.

Federal Reserve Is Required to Determine Continued Need for the Facilities and Provide Periodic Reporting

The Federal Reserve’s Regulation A provision applicable to emergency lending requires the Federal Reserve to conduct periodic analyses for assessing the continued need for facilities, and the CARES Act requires the Federal Reserve to provide periodic reports on the facilities to Congress.

Regulatory Requirement for Analysis

The Federal Reserve’s Regulation A requires, among other things, that at least once every 6 months, the Federal Reserve must monitor and analyze market conditions related to the facilities to determine if they are still needed.²⁰ The Federal Reserve Board must vote with no fewer than five members in agreement to extend past 1 year. Specifically, for a

²⁰12 C.F.R. § 201.4(d)(9).

facility to be extended, Regulation A requires that at least five members of the Federal Reserve Board must find that unusual and exigent circumstances continue to exist and the facility continues to appropriately provide liquidity to the financial system, and the Federal Reserve Board must obtain approval from the Secretary of the Treasury.

Staff from the Federal Reserve and the Reserve Banks said that a group of staff conducts the analyses, reviews legal requirements to ensure the analyses comply with regulatory requirements, and documents results in a briefing packet for the Federal Reserve Board. Next, staff said that subject-matter experts review the packet and make a recommendation to terminate or extend the facilities. They then send the updated packet with recommendations to the Federal Reserve Board for a vote. Staff said that the Board makes a final decision based on the information, recommendation, and discussion with Treasury principals, including the Secretary of the Treasury.

Based on our review of the Federal Reserve's work, we found that the determination analyses in 2020 included reviews of the following:

- market conditions, supported by analysis of interest rate spreads and issuance rates;
- facilities' potential effects on market functioning, such as facilities' usage rate and whether the announcement and presence of a facility may have restored market confidence and improved market health; and
- market disruptions stemming from COVID-19, such as the pandemic's effects on the broader economy—including unemployment claims and effects of stay-at-home orders on the financial health of businesses and municipalities.

In July 2020, the Federal Reserve Board determined, with the Secretary of the Treasury's approval, that unusual and exigent circumstances continued to exist and that the need for facilities remained. It therefore extended all of the CARES Act facilities set to terminate in September 2020 through December 31, 2020.²¹ As part of the determination, the Federal Reserve also extended the non-CARES Act facilities, which were

²¹The Municipal Liquidity Facility's termination date was already December 31, 2020, and the date was established in April 2020.

CARES Act Reporting Requirements

set to expire in September 2020, through at least the end of 2020.²² On November 19, 2020, Treasury announced that all CARES Act facilities will stop purchasing eligible assets or extending credit on December 31, 2020. On November 30, 2020, the Federal Reserve and Treasury extended the non-CARES Act facilities through March 31, 2021. Going forward, the Federal Reserve and Treasury can determine whether to further extend the non-CARES Act facilities.

In addition to the required determination of whether the need for the facilities persists, the Federal Reserve and Reserve Banks also continually monitor the facilities' performance. Staff from the Federal Reserve Board and Reserve Banks said that they continually monitor several indicators, including participation levels and volumes of transactions for the facilities, to track the facilities' performance. Staff also said that since the pandemic began, they have started examining and tracking conditions in various markets such as the municipal debt and corporate bond markets, to assess the health of the markets served by the facilities.

Section 13(3) of the Federal Reserve Act requires the Federal Reserve to provide periodic reports on the facilities to Congress.²³ The CARES Act imposes Section 13(3) reporting requirements and requires that the Federal Reserve publish these reports on its website. Accordingly, the Federal Reserve publishes these reports for all CARES Act facilities, along with transaction-level data, such as information on the bond issuer (for the corporate credit facilities), lender (for the Main Street facilities), borrower, loan amount, and other loan-related information such as the interest rate and maturity date.²⁴ The Federal Reserve provides similar reporting for the Paycheck Protection Program Liquidity Facility. For the non-CARES Act facilities (other than the Paycheck Protection Program Liquidity Facility), the Federal Reserve provides reports to Congress,

²²The Commercial Paper Funding Facility's termination date was already March 17, 2021, and this date was established when the facility was announced.

²³Section 13(3) requires the Federal Reserve to report to Congress every 30 days on the outstanding balance of each facility, including the value of the collateral posted; the amount of interest, fees, and other revenue or items of value received in exchange for the assistance; and any expected taxpayer losses for such assistance.

²⁴In addition to the required reporting, the Federal Reserve Board publishes the weekly report, "Factors Affecting Reserve Balances of Depository Institutions and Condition Statement of Federal Reserve Banks" (also known as H.4.1 statistical release). This report includes the aggregate balance of the special purpose vehicles supporting the facilities and, where relevant, provides additional information about its net portfolio holdings.

pursuant to Section 13(3) requirements. Although not legally required, the Federal Reserve also publishes on its website the reports for the non-CARES Act facilities.

Federal Reserve officials said that Section 13(3)(C)(ii) does not require the Federal Reserve to disclose transaction-level data, and under the Section 13(3)(D) confidentiality provision, the Federal Reserve Board Chair may request that certain information—the identity of the facilities’ participants, amounts borrowed by each participant, and identifying details of the collateral provided by a participant—be kept confidential and reported only to certain members of Congress. Officials explained that the Federal Reserve Board Chair requested confidential treatment of this information for the Primary Dealer Credit Facility, Commercial Paper Funding Facility, and Money Market Mutual Fund Liquidity Facility because publicly disclosing this information could adversely affect these facilities’ participants. For example, market stakeholders may perceive an entity’s participation in these facilities as a sign of the entity’s financial trouble which may lead to a run on the entity’s liquidity.

Federal Reserve Developed and Began Implementing a Framework to Oversee the Facilities’ Controls

When the Federal Reserve began developing the system of internal controls for the CARES Act and non-CARES Act facilities, it used existing control structures within the Federal Reserve System as a starting point. For example, the Federal Reserve Board and Reserve Banks have established policies, procedures, and other controls for their ongoing operations, such as for managing credit risk. As a result, any controls for CARES Act Section 13(3) facilities and programs were built on and interfaced with the existing system of internal controls. Based on our interviews with RBOPS officials and review of RBOPS oversight documentation, the Federal Reserve’s controls for the facilities exist at three levels:

- At the lowest level, at each of the Federal Reserve Banks, management is accountable for the design, implementation, and operating effectiveness of internal controls.
- Next, risk management functions are put in place at each of the Reserve Banks through the assurance, internal audit, and enterprise risk management roles and responsibilities.
- Finally, the highest-level controls exist at the Federal Reserve Board, which include oversight of the facilities by RBOPS.

To fulfill its responsibilities for overseeing the facilities on behalf of the Federal Reserve System, RBOPS developed and documented a general framework and approach to oversight, consisting of three phases.

- **First phase.** During its initial phase of oversight, RBOPS, through communication with Reserve Bank staff, focused on providing assistance in setting up the various facilities quickly.
- **Second phase.** As the facilities became operational, RBOPS reviewed the facilities' established governance structures, process workflows, and internal control design. Their objectives were to help the Reserve Banks identify any enhancements early in the facilities' life and obtain reasonable assurance that the design of controls and processes was adequate to ensure the facilities' effective operation. At the time of our review, RBOPS had not yet completed the second-phase reviews of all of the facilities. As of October 27, 2020, RBOPS had completed second-phase reviews for eight facilities.
- **Third phase.** Following the completion of these reviews, RBOPS plans to maintain ongoing monitoring activities. These include continued communication with Reserve Banks and periodic reviews of facility operations and controls to obtain reasonable assurance that controls are present and are functioning in a manner that addresses identified risks. We will continue to review the progress of the remaining second- and third-phase reviews as part of our ongoing work on the Federal Reserve facilities.

During the first phase of its oversight, RBOPS identified two focus areas for its oversight efforts—(1) transparency and information, and (2) credit program operations. According to RBOPS officials, the transparency and information focus area recognizes the importance of transparency to ensure the effective management of the facilities and of providing reliable information to Congress and the public. RBOPS added that the credit program operations focus area reflects the Board's interest in ensuring that the Reserve Banks implement and operate the credit programs in a manner that is consistent with the authorized terms and that demonstrates appropriate accountability.

Additionally, as part of the first phase of oversight, RBOPS documented several specific methods under which Board staff are expected to constructively engage with Reserve Bank staff, including (1) liaising with the Reserve Banks as they set up the facilities and implemented business processes and internal controls, (2) establishing communication with Reserve Banks for notification of risk incidents as they occurred, (3)

obtaining notification of vendor relationships that the Reserve Banks planned to pursue in support of the facilities, (4) discussing accounting policy and financial reporting matters with Reserve Banks, and (5) determining that Reserve Bank-provided funds are used in accordance with program terms.

As RBOPS transitioned to the second phase of its oversight and further documented its approach to oversight, it divided the two oversight focus areas of transparency and information and credit program operations into four focus areas: (1) compliance, governance, and risk management; (2) credit and collateral; (3) processes and controls; and (4) accounting and reporting.

- **Compliance, governance, and risk management.** RBOPS designed the compliance, governance, and risk management focus area to determine whether programs are conducted in accordance with Board authorizations and applicable laws, whether roles and responsibilities for the design and operation of the programs are clearly defined and understandable, and whether appropriate risk management structures are in place.
- **Credit and collateral.** The credit and collateral focus area seeks to evaluate whether practices for assessing credit risk are consistent with related policies, whether processes are in place for validating collateral eligibility, whether procedures for valuation of investments and collateral are consistent with related policies, and whether procedures with respect to asset disposition and facility wind-down are documented and carried out in accordance with authorizations.
- **Processes and controls.** The processes and controls focus area aims to determine whether internal systems and resources provide reasonable assurance that programs can be administered in accordance with authorizations, whether internal controls ensure that programs are managed in accordance with authorizations, and whether contracted services with third parties that are directly related to the programs are operated in accordance with policies.
- **Accounting and reporting.** The accounting and reporting focus area includes a determination of whether accounting policies and data are appropriately considered and designed in a manner that ensures compliance with accounting principles and facilitates financial reporting.

For each area, RBOPS documented specific oversight activities for addressing a given oversight objective. For example, oversight activities for the compliance, governance, and risk management focus area include

discussing with Reserve Banks' management the steps taken to ensure that policies related to conflicts of interest and ethical compliance are followed. Additionally, RBOPS performed a risk assessment that identified risk areas of focus for its second-phase reviews, mapped how the focus areas address those risks, and according to RBOPS officials, helped to identify the needed skillset for the review teams.

For the second phase of its oversight, RBOPS planned to begin the review of each facility no later than 45 days after the Board authorized the facility. RBOPS officials explained that they experienced delays in starting the second-phase reviews because of a number of factors, such as when facilities commenced lending activities as well as efforts to sequence the reviews to better assist collaboration with Reserve Banks and effective use of RBOPS resources. As a result, RBOPS did not begin reviews of any facilities within 45 days after a facility was established. At the time of our review, RBOPS had completed second-phase reviews for the Primary Dealer Credit Facility and Commercial Paper Funding Facility and provided us with the results and supporting documentation.

As part of the reviews, RBOPS interviewed Reserve Bank officials and communicated its expectations of Reserve Bank management. For example, RBOPS sent a memorandum to the first vice presidents of the Reserve Banks setting forth its expectations of actions each Reserve Bank would need to take to facilitate the bank's oversight and reviews. As they implement the facilities, Reserve Banks are expected to comply with applicable policies and controls and to continually mature them to ensure a high level of accountability. Additionally, RBOPS evaluated controls documented in the facilities' business process narratives, and it assessed the effect of instances in which a Reserve Bank or vendor noted that it mistakenly did not follow applicable policies or procedures.

At the conclusion of each facility's review, RBOPS summarized any control design gaps it identified and communicated its findings and recommendations for remediation to Reserve Bank management. RBOPS identified gaps in the design of controls for the Primary Dealer Credit Facility and did not identify any gaps for the Commercial Paper Funding Facility. RBOPS determined that the design of the controls for both facilities would provide reasonable assurance that facilities' operations are conducted effectively. According to RBOPS officials, the results of the phase two reviews will provide a basis for reassessing risk in the phase three reviews and inform the ongoing monitoring of the facilities.

Conditions in Corporate Credit Markets Have Improved, and the Corporate Credit Facilities Have Had Relatively Limited Activity

The COVID-19 pandemic disrupted financial markets, including corporate bond markets and short-term corporate credit markets. In response, the Federal Reserve reinstated previously used emergency lending facilities to stabilize these credit markets. Since then, corporate credit markets have generally stabilized, with rates moderating since the COVID-19-related disruptions in March and April 2020. Corporate bond issuances have also increased and, from March through September, companies nearly doubled the amount of corporate bonds issued in 2020 compared to the same period in 2019. The corporate credit facilities have had limited activity, but they likely were a factor in restoring confidence among market participants.

Short-Term Corporate Credit Markets Have Improved Since the Onset of the COVID-19 Pandemic

After the onset of market stress caused by the COVID-19 pandemic and the Federal Reserve's implementation of emergency lending facilities in March and April 2020, short-term corporate credit markets stabilized.²⁵ In March 2020, the Federal Reserve had responded to market disruptions from the COVID-19 pandemic by taking a number of measures, including establishing emergency lending facilities.²⁶ The Federal Reserve announced that it was reinstating three emergency lending facilities that had previously been active from 2008 to 2010: the Primary Dealer Credit Facility, the Commercial Paper Funding Facility, and the Money Market Mutual Fund Liquidity Facility.²⁷ Each of these facilities is intended to provide liquidity to short-term financial markets such as the commercial paper market and prime money market funds. By August, spreads in the commercial paper market declined while issuances and outstanding balances decreased and outflows from prime money market funds

²⁵Corporations use short-term corporate credit markets to issue debt such as commercial paper to meet short-term funding needs such as making payroll. Because of short maturities, many businesses must frequently issue new short-term debt to pay off expiring debt.

²⁶In addition to establishing lending facilities, the Federal Reserve took regulatory and monetary policy actions to support the flow of credit to households, businesses, and the U.S. economy.

²⁷The Primary Dealer Credit Facility differs from the 2008 version of the facility, most notably in that it allows loans up to 90 days, while the 2008 version of the facility offered only overnight loans. The Money Market Mutual Fund Liquidity Facility is very similar in structure to the Asset-Backed Commercial Paper Money Market Mutual Fund Liquidity Facility that operated from 2008 to 2010, but it accepts a broader range of assets.

reversed, indicating improved credit conditions for short-term funding for large businesses.²⁸

Commercial Paper

Commercial Paper

Commercial paper is short-term debt issued primarily by corporations. The commercial paper market is an important source of short-term credit for a range of financial and non-financial businesses that may rely on it to make payroll or for other short-term funding needs. Municipalities can also issue commercial paper for short-term funding needs, and asset-backed commercial paper finances certain consumer loans such as auto loans. Because commercial paper involves short maturities, many businesses must frequently issue new commercial paper to pay off expiring commercial paper.

Source: Congressional Research Service. | GAO-21-180

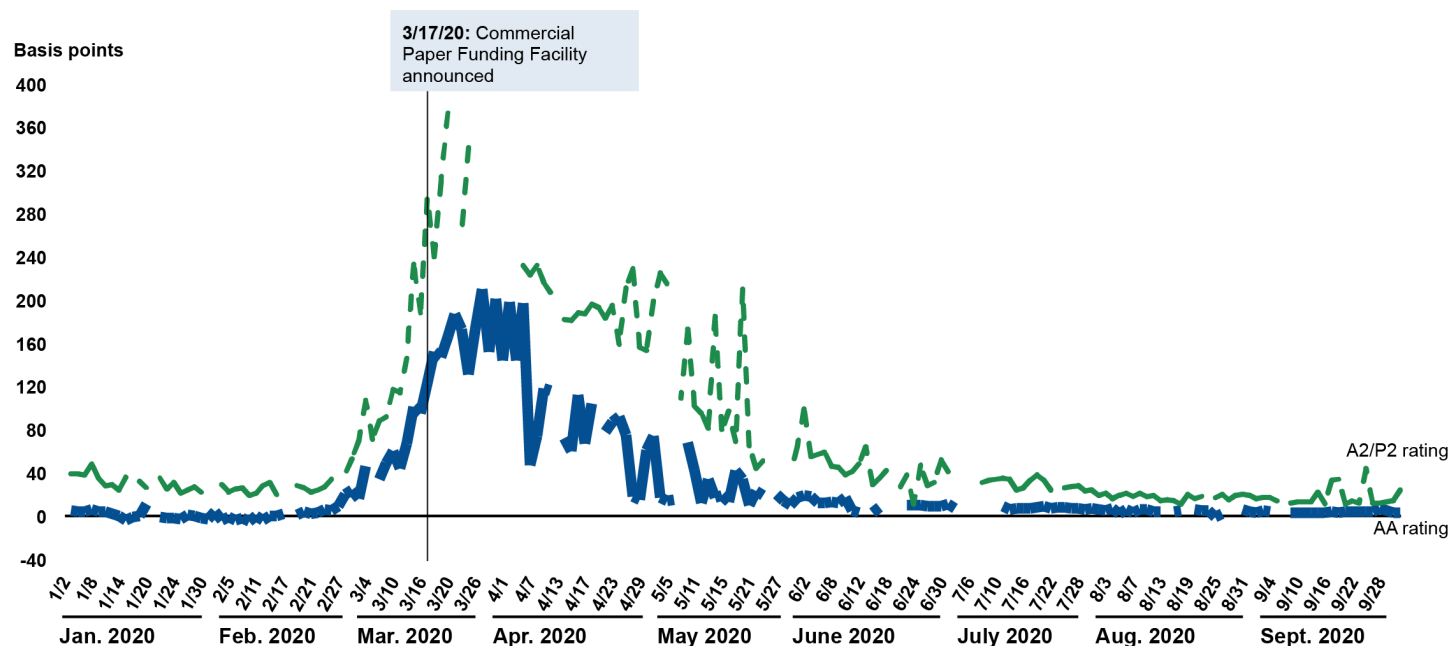
During the COVID-19-related market stress in March 2020, the cost of issuing commercial paper rose as investors grew reluctant to buy new commercial paper. (See sidebar for an explanation of commercial paper.) Credit spreads are financial market indicators that compare the yield of a financial security to the yield of a benchmark security, such as a Treasury security. Spreads are measures of price and reflect the premium that borrowers must pay to compensate lenders for taking on the risk of loss due to default and for forgoing investments in more liquid assets.

When the Federal Reserve announced the Commercial Paper Funding Facility on March 17, 2020, the spread between high-rated (that is, investment grade) commercial paper and the benchmark rate was 152 basis points, while the spread between lower-rated (that is, non-investment grade) commercial paper and the benchmark rate was 240 basis points.²⁹ By comparison, spreads on both high-rated and lower-rated commercial paper were below 54 basis points during the pre-pandemic period. Since March 17, 2020, spreads on commercial paper have declined, and as of September 2020, spreads had returned to their pre-pandemic levels (see fig. 3).

²⁸Spreads are the difference in yields between a security (such as commercial paper) and a safer asset (such as a Treasury security) with similar timing of interest and principal payments.

²⁹One basis point is equal to 1/100th of 1 percent. Spreads are the difference between the commercial paper rate and the overnight indexed swap of the same maturity. High-rated commercial paper is commercial paper with at least one “1” or “1+” rating, but no ratings other than “1,” according to the rating agencies Moody’s or Standard & Poor’s.

Figure 3: Spreads on 90-day Commercial Paper for Large Nonfinancial Businesses, January 2020–September 2020



Source: GAO analysis of Bloomberg and Board of Governors of the Federal Reserve System data. | GAO-21-180

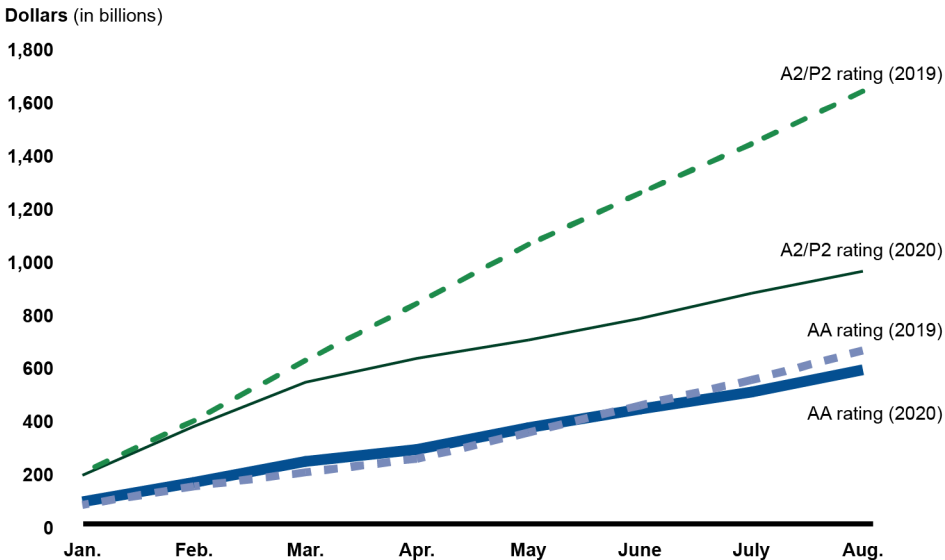
Notes: An AA rating is for issuers with at least one “1” or “1+” rating, but no ratings other than “1,” according to the rating agencies Moody’s or Standard & Poor’s. An A2/P2 rating is for issuers with at least one “2” rating, but no ratings other than “2.” A line is broken if there are no data for the category on that date. A basis point is 1/100th of a percentage point. The spread is the difference between the commercial paper rate and the overnight indexed swap of the same maturity.

The chart is for large nonfinancial businesses, and the movements of the spreads are similar for commercial paper issued by large financial businesses.

Issuances of commercial paper from January through August 2020 generally declined compared to the same period in 2019 (see fig. 4). Issuances especially declined for lower-rated commercial paper as COVID-19 began to stress markets in March. Lower-rated issuances in January through August 2020 were 42 percent lower than in the same period in 2019. As of September 2020, net flows of commercial paper among large nonfinancial businesses were down 45 percent from their January 2020 level, suggesting that large nonfinancial businesses may have been facing challenges refinancing their short-term unsecured debt as a result of the uncertainty associated with COVID-19. However, reduced issuances and balances of commercial paper may also indicate that businesses have shifted away from short-term financing in the

commercial paper market in favor of longer-term financing in the corporate bond market, as discussed later in this report.³⁰

Figure 4: Cumulative Issuances of Commercial Paper for Large Nonfinancial Businesses, January–August, 2019 and 2020



Source: GAO analysis of Board of Governors of the Federal Reserve System data. | GAO-21-180

Note: An AA is for issuers with at least one “1” or “1+” rating, but no ratings other than “1,” according to the rating agencies Moody’s or Standard & Poor’s. An A2/P2 is for issuers with at least one “2” rating, but no ratings other than “2.” The issuances of commercial paper include both domestic and foreign issues, and all other issues (including unknown domicile or industry of issuers).

Prime Money Market Funds

Prime Money Market Funds

A money market fund is a type of mutual fund that is required by law to invest in low-risk securities. Money market funds act as intermediaries between investors seeking highly liquid, safe investments and corporate and government entities that issue short-term debt to fund operations. Prime money market funds, one category of money market funds, primarily invest in short-term corporate and bank debt such as commercial paper, though they may also hold U.S. government-backed securities such as U.S. Treasury securities.

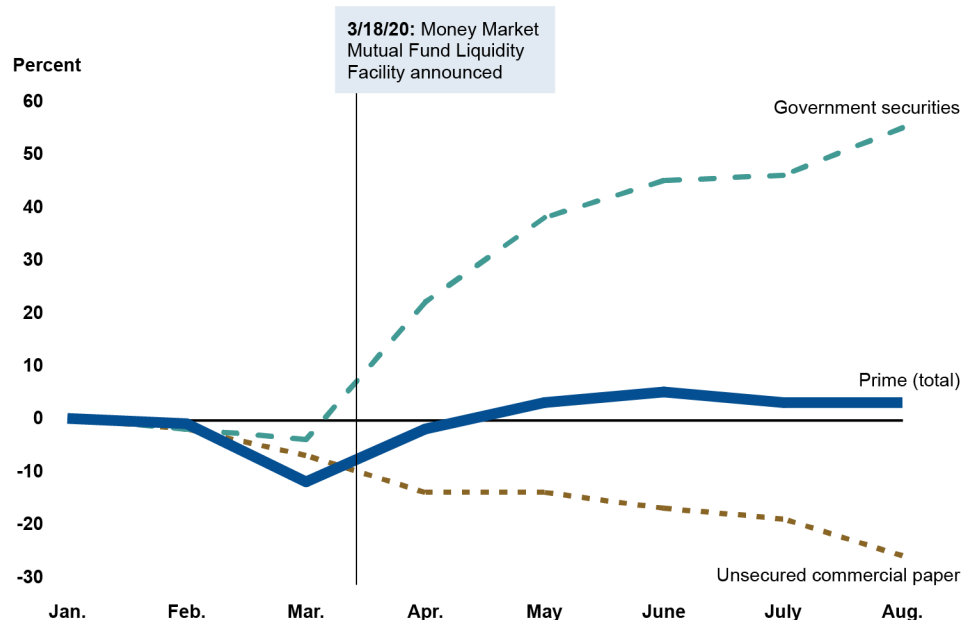
Source: GAO. | GAO-21-180

Prime money market funds experienced net outflows—that is, investors withdrew more money overall from the funds than they added—as investors withdrew money during the COVID-19-related market stress in March 2020. (See sidebar for an explanation of prime money market funds.) Prime money market assets under management declined 12 percent in March compared to their January level. The Federal Reserve announced the Money Market Mutual Fund Liquidity Facility on March 18, 2020, to assist money market funds in meeting demands for redemptions by investors and to foster liquidity in markets for the assets typically held by money market funds.

³⁰Outstanding balances for commercial paper of asset-backed securities, financial issuers, and all other issuers decreased by 5, 31, and 1 percent, respectively, from January to September 2020.

By August 2020, prime money market assets under management had rebounded to their January level (see fig. 5). During this period, prime money market funds reduced their holdings of commercial paper—particularly unsecured commercial paper—while increasing their holdings of government-backed securities.³¹ Because government-backed securities are considered safer than commercial paper, this shift may indicate that prime money market fund managers and investors perceived increased uncertainty in the commercial paper market (see previous discussion).

Figure 5: Net Flows of Prime Money Market Funds, January 2020–August 2020



Source: GAO analysis of Board of Governors of the Federal Reserve System data. | GAO-21-180

Note: The chart shows cumulative percentage net flows of money market funds outstanding since January 2020. The total value of prime money market funds outstanding in January 2020 was \$1.1 trillion.

The Commercial Paper Funding Facility and Money Market Mutual Fund Liquidity Facility were most active shortly after they became operational in March and April 2020, when disruptions in credit markets were most pronounced, and the latter was designed to work in concert with the

³¹The prime money market funds also invest in certificates of deposit, asset-backed commercial paper, and other instruments.

former.³² The Primary Dealer Credit Facility was also most active during this period. The Federal Reserve established this facility to make loans to primary dealers in exchange for a wide range of collateral, including Treasury securities, corporate bonds, commercial paper, and asset-backed securities.³³ As of November 15, 2020, more than 90 percent of the total transaction volume conducted, or total dollar amount of loans made or assets purchased, by these three facilities had occurred before May 15 (see table 4). As markets became more stable, activity in these facilities sharply declined.

Table 4: Transaction Volume for the Primary Dealer Credit Facility, Commercial Paper Funding Facility, and Money Market Mutual Fund Liquidity Facility, March 2020–November 2020

Facility transaction volume (\$ in millions)

Date (2020)	Primary Dealer Credit Facility (operational March 20)	Commercial Paper Funding Facility (operational April 14)	Money Market Mutual Fund Liquidity Facility (operational March 23)
Before Apr. 15	83,470	947	57,714
Apr. 16–May 15	34,935	3,295	297
May 16–June 15	6,488	0	0
June 16–July 15	2,128	30	0
July 16–Aug. 15	1,796	0	0
Aug. 16–Sept. 15	725	0	0
Sept. 16–Oct. 15	288	0	0
Oct. 16–Nov. 15	400	0	0
Total	130,230	4,272	58,012

Source: GAO analysis of Board of Governors of the Federal Reserve System data | GAO-21-180

Note: Monthly volumes may not sum to total due to rounding.

³²By allowing issuers to buy back outstanding commercial paper and re-issue it using the Commercial Paper Funding Facility, the facility reduces the strain placed on money market funds invested in commercial paper. At the same time, by providing liquidity support to money market funds, the Money Market Mutual Fund Liquidity Facility mitigates the risk that money market funds would be forced to sell commercial paper into an illiquid market, preventing further market disruption.

³³Primary dealers are a group of banks and broker-dealers designated by the Federal Reserve Bank of New York to serve as trading counterparties in the implementation of monetary policy. As of October 29, 2020, there were 24 primary dealers.

Conditions in the Corporate Bond Market Have Generally Improved and Corporate Credit Facilities Have Had Limited Activity

Corporate bond spreads have improved (declined) since the onset of disruptions to the corporate bond market resulting from the COVID-19 pandemic. In response to the disruptions, in March 2020, the Federal Reserve announced the Primary Market Corporate Credit Facility and Secondary Market Corporate Credit Facility to support the flow of credit to companies. It also established the Term Asset-Backed Securities Loan Facility to support the flow of credit to consumers and businesses, because, compared with 2019, the reduction in issuances of asset-backed securities since February 2020 suggested that the market was uncertain about households' ability to make payments on their loans. Overall, the facilities have had limited activity relative to their capacity.

Corporate Bond Market

Corporate Bonds

In the corporate bond market, large companies issue and sell bonds to investors in exchange for cash. Bond investors function as lenders who generally receive payments of principal plus interest over a period of time. The borrowing cost and liquidity for companies that issue corporate bonds are largely determined by credit ratings, which are assigned by credit rating agencies and intended to indicate the companies' investment risks and payment capabilities. Bonds rated above a certain threshold are called investment grade bonds.

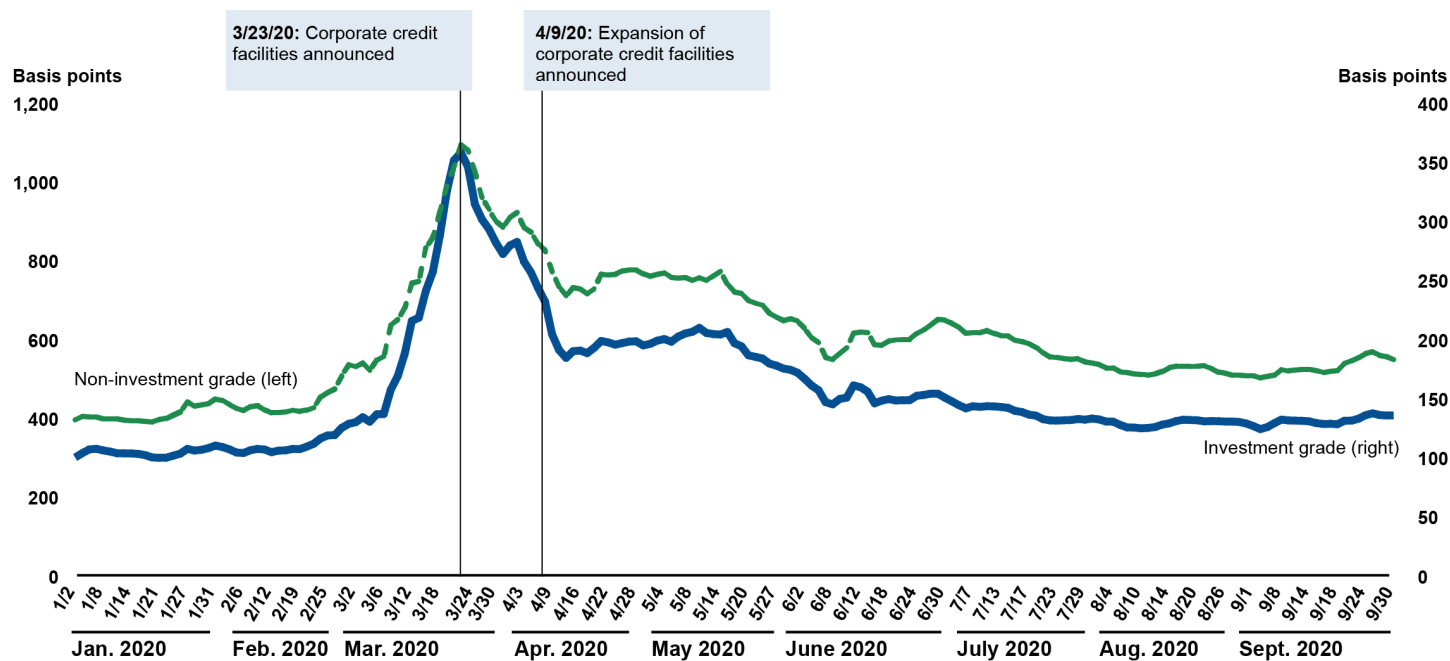
Source: Congressional Research Service. | GAO-21-180

The corporate bond market was disrupted in March 2020 during the onset of the COVID-19 pandemic. (See sidebar for an explanation of corporate bonds.) Bonds became more expensive to issue as investors had lower confidence in large companies' ability to repay their debts. On March 23, 2020, spreads on investment grade corporate bonds exceeded 350 basis points—350 basis points higher than the benchmark interest rate—and spreads on non-investment grade corporate bonds exceeded 1000 basis points.³⁴ By comparison, those spreads were under 200 basis points and under 534 basis points, respectively, in the pre-pandemic period.

In the months since the COVID-19-related market stress and the Federal Reserve's announcement of emergency lending facilities in March 2020, corporate bond spreads have moderated. Since March 23, 2020, spreads on corporate bonds have declined, and as of September 2020 were under 150 basis points for investment grade bonds and 600 basis points for non-investment grade bonds (see fig. 6). However, the spreads are still elevated relative to those in January 2020, suggesting that stress in corporate bond markets has not fully abated and concerns about default risk persist, especially for non-investment grade bonds.

³⁴Option-adjusted spreads on dollar-denominated investment grade and non-investment grade bonds are available through Bloomberg's Fixed Income Credit Monitoring.

Figure 6: Spreads on Corporate Bonds, January 2020–September 2020

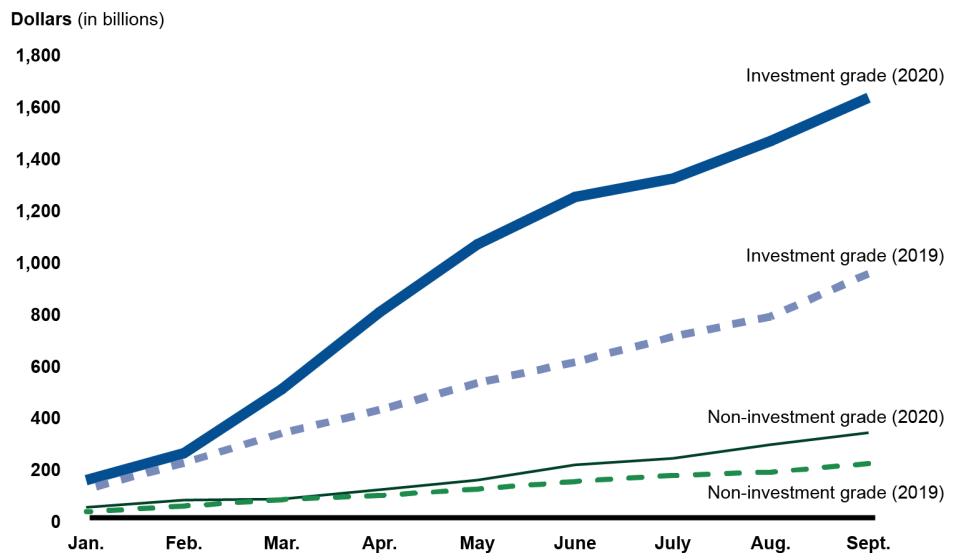


Source: GAO analysis of Bloomberg data. | GAO-21-180

Note: Option-adjusted spreads on dollar-denominated investment grade and non-investment grade bonds are available through Bloomberg's Fixed Income Credit Monitoring. A basis point is 1/100th of a percentage point.

Issuances of non-investment grade corporate bonds in 2020 are 57 percent higher than in 2019 (January to September), and issuances of investment grade corporate bonds are 72 percent higher than the same period in 2019 (see fig. 7). Increased issuances of investment grade corporate bonds demonstrate that highly rated issuers have access to longer-term credit in the private marketplace. Additionally, companies may be issuing debt to replace the decline in their revenues due to the pandemic, may be shifting from short-term debt to longer-term debt to reduce uncertainty, or may be refinancing existing debt ahead of schedule to take advantage of low overall interest rates.

Figure 7: Cumulative Issuances of Corporate Bonds, January–September, 2019 and 2020



Source: GAO analysis of Securities Industry and Financial Markets Association data. | GAO-21-180

Note: Figure excludes all issuances with maturities of 1 year or less and certificates of deposit.

Asset-Backed Securities

Asset-Backed Securities

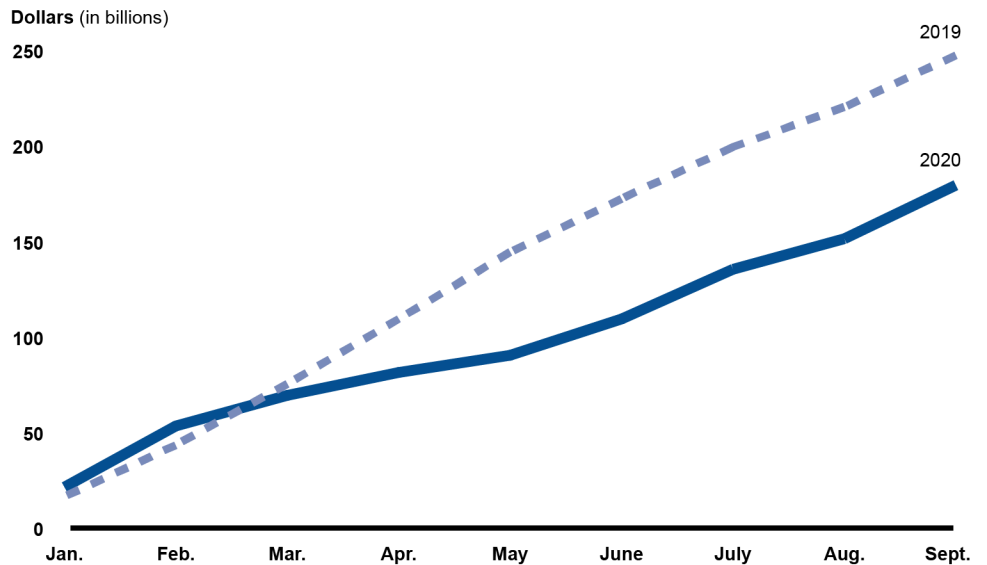
Asset-backed securities are tradable securities backed by pools of assets, such as loans, leases, or other cash-flow producing assets. The holders of asset-backed securities are entitled to payments that are distributed by the underlying assets. Common underlying assets for asset-backed securities include auto loans and leases, credit card loans, student loans, insurance premiums, commercial mortgages, and small business loans guaranteed by the Small Business Administration. Well-functioning markets for asset-backed securities benefit borrowers—who may gain access to funds with more favorable terms—and lenders, who may better manage their capital and diversify their income streams.

Source: GAO. | GAO-21-180

Issuances of asset-backed securities declined during the COVID-19 pandemic, compared to 2019. (See sidebar for an explanation of asset-backed securities.) Total asset-backed security issuances from March to September 2020 fell below those of the same period in 2019, with some sectors seeing very few issuances.

In light of the disruptions, the Federal Reserve re-activated the Term Asset-Backed Securities Loan Facility that it had previously used from 2008 to 2010. The facility, which is intended to enable the issuance of asset-backed securities and therefore encourage lending to consumers and businesses, was announced on March 23, 2020, and became active on June 17, 2020. From January to September 2020, total issuances of asset-backed securities were \$179 billion, which is 73 percent of the \$247 billion total issuances in the same period in 2019 (see fig. 8). Credit card loans had the largest decrease of 91 percent. The ongoing reduction in issuances of asset-backed securities since February, compared with 2019, suggests that the market is uncertain about households' ability to make payments on their loans.

Figure 8: Cumulative Issuances of Asset-Backed Securities, January–September, 2019 and 2020



Source: GAO analysis of Securities Industry and Financial Markets Association data. | GAO-21-180

The corporate credit facilities have had limited activity relative to their capacity. Combined, the two facilities conducted transactions totaling less than 2 percent of their maximum capacity of \$750 billion, as of November 15, 2020.³⁵ The Secondary Market Corporate Credit Facility was active in the months after it was launched in May 2020, but the pace of purchases has slowed substantially since July 2020. As of November 15, 2020, more than 80 percent of the facility's total transaction volume of \$13.6 billion had occurred before July 15, 2020.

The facility's pace of corporate bond purchases—which are made in the secondary market from various bond holders and not from bond issuers—is determined by an array of measures of bond market functioning. If these measures indicate sustained improvement in market functioning, purchases can slow notably or pause entirely. Officials told us that Federal Reserve Bank of New York staff with relevant market expertise determined how the pace of purchases would relate to measures of bond

³⁵The Federal Reserve announced that the corporate credit facilities would purchase a maximum combined amount of \$750 billion in bonds, bond exchange-traded funds, and syndicated loans. As of November 15, 2020, the corporate credit facilities had conducted a total of \$13.6 billion in transactions.

market functioning. They said staff receive daily updates on measures of bond market functioning from the facility's investment manager.

The Primary Market Corporate Credit Facility had not recorded a transaction as of November 15, 2020. The absence of transactions in the Primary Market Corporate Credit Facility is consistent with the narrowing of bond spreads and decreased distress in the bond market. Federal Reserve facilities are intended as a backstop, providing relief in times of market stress, but they are not expected to be used under normal conditions since the facilities charge above-market rates.³⁶ Federal Reserve officials stated that the creation of emergency lending facilities as a backstop ideally improves market conditions by restoring the confidence of market participants, causing the facilities' capacity to be largely unused unless conditions worsen.

Officials also said that improvements in corporate bond market function demonstrated the positive effect of the facilities' announcement. Corporate bond spreads fell in the weeks after the Federal Reserve announced the corporate credit facilities on March 23, then fell again in the weeks after the Federal Reserve announced the expansion of the corporate credit facilities on April 9.³⁷ One research economist who specializes in credit markets told us that the corporate credit facilities have been very effective because they reassured market participants and prevented forced sales. Although it is difficult to isolate the impact of the facilities' announcement and purchases from the impact of other interventions by the Federal Reserve and Congress, some studies have suggested that the facilities' announcements and purchases likely helped to rally the corporate bond market.³⁸

³⁶Under the Federal Reserve's Regulation A, emergency lending facilities must charge an interest rate that is a premium to the market rate in normal circumstances. 12 C.F.R. § 201.4(d)(7).

³⁷The change announced on April 9, 2020, expanded the corporate credit facilities to a maximum combined size of \$750 billion backed by a \$75 billion equity investment from Treasury's ESF. Previously, the Federal Reserve had announced that the corporate credit facilities, together with the Term Asset-Backed Securities Loan Facility, would provide up to \$300 billion in financing backed by \$30 billion in equity from Treasury's ESF.

³⁸See, for example, Nina Boyarchenko, Anna Kovner, and Or Shachar, *It's What You Say and What You Buy: A Holistic Evaluation of the Corporate Credit Facilities*, Federal Reserve Bank of New York Staff Reports, no. 935, July 2020. See also, Simon Gilchrist, Bin Wei, Vivian Z. Yue, and Egon Zakrajsek, "The Fed Takes on Corporate Credit Risk: An Analysis of the Efficacy of the SMCCF," NBER Working Paper Series, No. 27809, September 2020, <http://www.nber.org/papers/w27809>.

Through November 15, 2020, the Term Asset-Backed Securities Loan Facility had its highest level of transaction volumes in the 2 months after it became operational in June 2020 (see table 5). Transactions were concentrated in securities backed by commercial mortgages and by small business loans guaranteed by the Small Business Administration (SBA). As discussed above, overall issuances of asset-backed securities have declined substantially from January to September 2020, compared to the same period in 2019.

Table 5: Transaction Volume in the Primary and Secondary Market Corporate Credit Facilities and Term Asset-Backed Securities Loan Facility, March 2020–November 2020

Facility transaction volume (\$ in millions)

Date (2020)	Primary Market Corporate Credit Facility (operational June 29)	Secondary Market Corporate Credit Facility (operational May 12)	Term Asset-Backed Securities Loan Facility (operational June 17)
Before Apr. 15	-	-	-
Apr. 16–May 15	-	637	-
May 16–June 15	-	5,280	-
June 16–July 15	0	5,247	937
July 16–Aug. 15	0	989	1,329
Aug. 16–Sep. 15	0	542	383
Sep. 16–Oct. 15	0	453	593
Oct. 16–Nov. 15	0	432	639
Total	0	13,579	3,880

Source: GAO analysis of Board of Governors of the Federal Reserve System data | GAO-21-180

Note: Monthly volumes may not sum to total due to rounding.

Municipal Credit Markets Have Improved, but State and Local Governments Continue to Face Fiscal Challenges

Municipal Credit Markets Were Significantly Affected by COVID-19 and Have Since Improved, but Concerns Remain

COVID-19 caused deteriorating conditions in municipal credit markets, such as the municipal bond market and the related market for municipal variable rate demand notes (VRDN). Municipal bonds are debt instruments that state and local governments issue to finance transportation, housing, hospitals, education, and other diverse projects. Municipal bond spreads rose from pre-pandemic levels below 0 basis points to a high of 276 basis points on March 23, 2020, as institutional investors sold off municipal securities holdings.³⁹ VRDNs are long-term municipal securities that are payable on demand and accrue interest based on the prevailing money market rate—effectively making VRDNs short-term duration assets. VRDNs are the most commonly held type of asset in municipal money market funds.⁴⁰ The SIFMA municipal swap index of rates—a commonly used benchmark rate for VRDNs—more than quadrupled from March 11, 2020, to March 18, 2020, indicating a disruption in the VRDN market.

The Federal Reserve established the Municipal Liquidity Facility to enhance the liquidity of the short-term municipal securities market and help restore confidence in the municipal securities market. The Municipal Liquidity Facility purchases short-term municipal securities—for example, tax anticipation notes, which are short-term debt instruments to be paid from specific taxes due in the near future—from eligible states, cities, counties, or multi-state entities.⁴¹ Although the facility limits purchases to short-term securities typically used for cash management, Federal Reserve officials have said that the facility is intended to encourage investors to participate in the municipal securities market more broadly

³⁹Spreads on municipal bonds are calculated relative to interest rates on Treasury securities based on the Bloomberg-Barclays Municipal Bond Index and are measured in basis points (1/100th of a percentage point). Spreads measure the premium borrowers must pay to compensate lenders for taking on the risk of loss due to default and for forgoing investments in more liquid assets. Higher spreads reflect higher perceived risk among municipal borrowers by investors. A negative municipal spread has been prevalent historically, especially before the 2007–2009 financial crisis. The federal tax exemption of interest on municipal bonds (and state tax exemption for in-state bonds) and the perception of relatively low risk of these bonds could enable state and local governments to obtain financing at rates lower than Treasury securities on a before-tax basis.

⁴⁰Municipal money market funds include other assets.

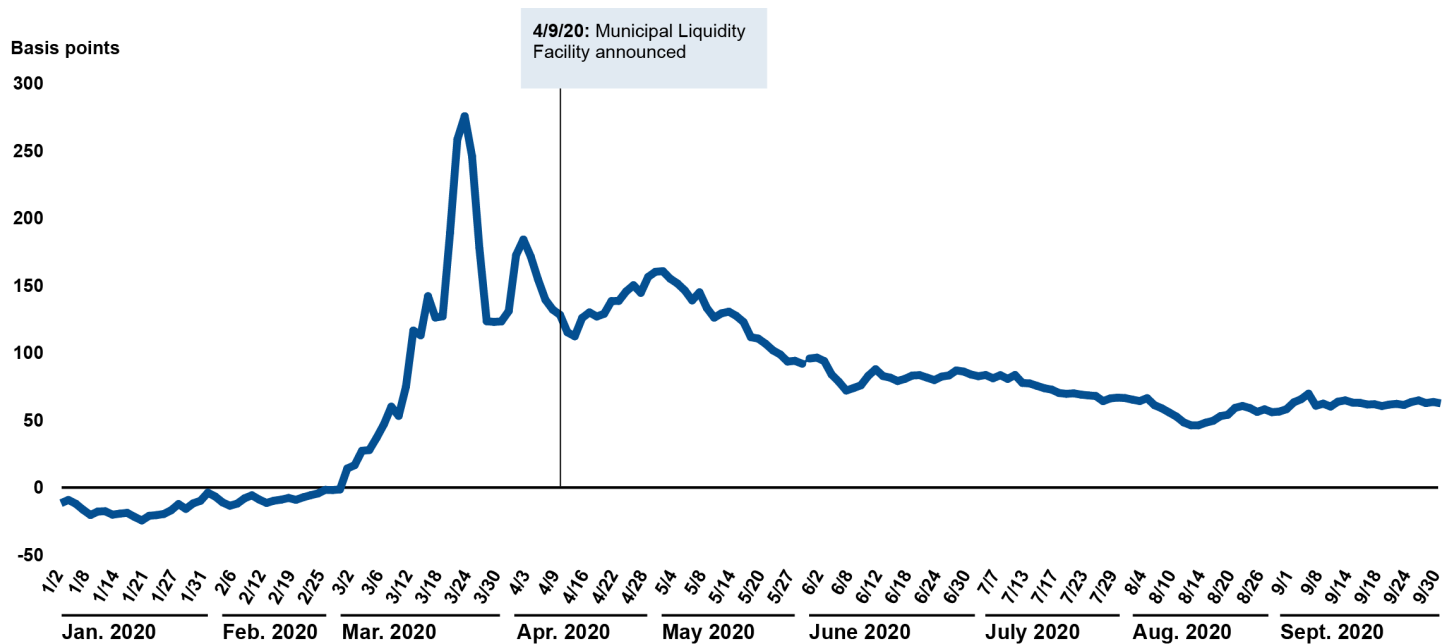
⁴¹Eligible states are U.S. states and the District of Columbia. Eligible cities and counties are U.S. cities and counties with a population exceeding 250,000 residents and 500,000 residents, respectively. State governors can also designate a limited number of cities, counties, or revenue bond issuers within their state as eligible. Revenue bond issuers are entities affiliated with state or local governments that issue bonds secured by revenue from a specified government-owned source. Borrowers must also meet credit rating requirements to be eligible.

and to support overall municipal market functioning. The Municipal Liquidity facility was announced on April 9, 2020, and became operational on May 26, 2020.

Conditions in the municipal bond market improved after March 2020. Spreads on municipal bonds have stabilized since the market disruptions in March and April, falling from a high of 276 basis points to levels around 60 basis points in September 2020, suggesting that perceived risk among municipal issuers has fallen and access to credit for state and local governments has improved (see fig. 9). While spreads remain above pre-pandemic levels, this may reflect very low interest rates on Treasury securities rather than an absence of demand for municipal bonds. Moreover, spreads are likely to be affected by other factors, including the uncertainty surrounding whether Congress will extend aid to help governments manage loss of tax revenues and increased expenditures related to the pandemic. Issuances of municipal bonds have increased in 2020, compared to the same period in 2019—especially for revenue bonds, compared with general obligation bonds.⁴²

⁴²Municipal bonds can be classified as either general obligation bonds or revenue bonds. General obligation bonds are backed by general revenues of the issuing municipality, while revenue bonds are repaid from the revenue generated by the specific project the bonds paid for, such as income from a toll road.

Figure 9: Spreads on Municipal Bonds, January 2020–September 2020



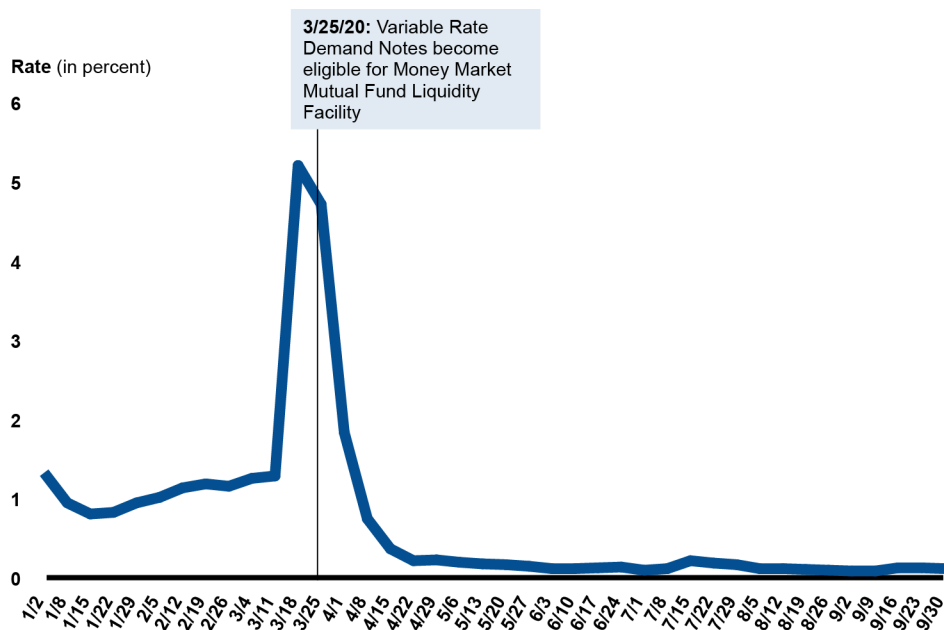
Source: GAO analysis of Bloomberg data. | GAO-21-180

Note: Spreads on municipal bonds are calculated relative to interest rates on Treasury securities based on the Bloomberg-Barclays Municipal Bond Index and are measured in basis points (1/100th of a percentage point).

VRDN market conditions have also improved since the market disruptions in March. After the SIFMA municipal swap index of rates more than quadrupled from March 11, 2020, to March 18, 2020, rising to 5.2 percent, it returned to pre-pandemic levels by early April (see fig. 10). Outflows of VRDNs in March reduced in August. As of September 30, 2020, the SIFMA municipal swap index of rates had been near zero since May, but outflows in August 2020 were 8 percent, indicating that the VRDN market had not fully recovered. On March 23, 2020, the Federal Reserve announced it was adding VRDNs to the list of eligible collateral for the Money Market Mutual Fund Liquidity Facility, and this likely played a role in the VRDN market's recovery.⁴³ Officials from associations representing state and local government finance professionals told us that the move created demand for VRDNs and was greatly welcomed by market participants.

⁴³On March 23, 2020, the Federal Reserve expanded the list of eligible securities for the Commercial Paper Funding Facility to include high-quality, tax-exempt commercial paper.

Figure 10: Municipal Swap Index of Rates on Tax-Exempt Variable Rate Demand Notes, January 2020–September 2020



Source: GAO analysis of Securities Industry and Financial Markets Association data. | GAO-21-180

Note: The index is a weekly non-weighted average of the reset rates of high-grade tax-exempt variable rate demand notes.

Use of the Municipal Liquidity Facility Has Been Limited and Many State and Local Governments Cannot Fund Operations Using Debt

As of November 15, 2020, the Municipal Liquidity Facility had completed two transactions with a total loan value of \$1.65 billion.⁴⁴ This represents less than half of 1 percent of the facility's ability to purchase up to \$500 billion of eligible notes. Officials from associations representing state and local finance professionals told us that city and county governments below the population size requirements cannot obtain loans through the facility unless they can borrow through their state government, which may not be willing to borrow on behalf of city and county governments as that may expose the states to additional risk. They also told us that their members are currently able to obtain lower rates for loans in the marketplace compared to the facility's rates. As previously mentioned, the Federal Reserve's Regulation A requires emergency lending facilities to charge an interest rate higher than the market rate in normal circumstances. On August 11, 2020, the Federal Reserve lowered the

⁴⁴The Municipal Liquidity Facility purchased \$1.2 billion of notes from the State of Illinois and \$0.45 billion of notes from New York's Metropolitan Transportation Authority.

interest rates that the Municipal Liquidity Facility requires, allowing borrowers to access the facility at a lower rate than originally announced.

Federal Reserve officials have said that the Federal Reserve does not measure the success of the Municipal Liquidity Facility based on its transaction volume, but rather on the condition of the municipal securities market and state and local government access to capital. As discussed above, conditions in the municipal bond market have improved since the COVID-19-related disruption in March and April 2020. On September 22, 2020, the Chair of the Federal Reserve Board testified that the Municipal Liquidity Facility has contributed to a strong recovery in municipal securities markets, with municipal issuers with a wide range of types, sizes, and ratings able to issue bonds with interest rates at or near historical lows.⁴⁵

Although conditions in municipal bond markets have improved, state and local governments face pressing budgetary challenges due to increased expenditures and decreased revenues stemming from COVID-19 and the resulting economic downturn. Specifically, state and local governments faced disruptions in the timing of revenues and expenditures, which has affected their budgets. For example, the majority of states extended their individual income tax filing deadlines to match the Internal Revenue Service's July 15 extended deadline for filing federal income tax returns, which delayed state and local government income tax revenues for 3 months. State and local governments have taken actions to respond to these challenges such as freezing hiring efforts, furloughing staff, restricting contracts and new spending, and freezing discretionary spending. Additionally, a number of states have used their reserve funds to balance budgets for fiscal year 2020.

Small Businesses Face Credit Challenges and, to Date, the Main Street Facilities Have Had Limited Participation

⁴⁵Jerome Powell, testimony before the House Committee on Financial Services, September 22, 2020.

Small Businesses Generally Face a Lack of Available Funding in the Credit Market

Small businesses have been particularly vulnerable to large and sustained losses of revenue resulting from COVID-19, and they generally lack available funding in the credit market. Of particular concern are the effects the pandemic is having and will likely continue to have on small businesses as they endure the direct impacts of social distancing directives, including temporary closures and modified operations. With declining revenues, many small businesses have had to lay off employees.

Before the pandemic, small businesses were generally financially fragile, and they were therefore vulnerable to the large and sustained loss of revenue the pandemic has caused. For example, according to the Federal Reserve Banks' 2020 Small Business Credit Survey, 88 percent of small business owners typically rely on their personal credit score to secure financing, and 56 percent of all small business owners have relied on funds from their personal savings, friends, or family to support operations in the past 5 years.⁴⁶ Additionally, 47 percent stated that they would rely on personal funds if they needed to fill a 2-month gap in revenues. Further, among small businesses that applied for financing in the prior 12 months, 46 percent stated that they would plan to take out additional debt. According to another study, at the onset of the pandemic, approximately 75 percent of small businesses surveyed did not have enough cash on hand to cover more than 2 months of expenses.⁴⁷

The Federal Reserve has taken measures to support the flow of credit to small businesses. Specifically, to provide liquidity to financial institutions participating in SBA's PPP, it authorized each of the 12 Federal Reserve Banks to establish and operate the Paycheck Protection Program Liquidity Facility to extend credit on a nonrecourse basis to eligible financial institutions that originate PPP loans, taking the loans as

⁴⁶Federal Reserve Banks of Atlanta, Boston, Chicago, Cleveland, Dallas, Kansas City, Minneapolis, New York, Philadelphia, Richmond, St. Louis, and San Francisco, *Small Business Credit Survey: 2020 Report on Employer Firms* (New York, NY: 2020). The survey was conducted in the third and fourth quarters of 2019, with 5,514 responses from small employer businesses with fewer than 500 full or part-time employees in the 50 states and the District of Columbia.

⁴⁷See Alexander W. Bartik et al., "The Impact of COVID-19 on Small Business Outcomes and Expectations," *Proceedings of the National Academy of Sciences of the United States of America*, vol. 117, no. 30 (July 28, 2020). The study was based on more than 5,800 small businesses that are members of Alignable, a network of 4.6 million small businesses. The survey was conducted from March 28 through April 4, 2020.

collateral.⁴⁸ The facility is not a CARES Act facility because it does not receive funding from the CARES Act, but it was created to support the PPP—a CARES Act program. Since establishment of the facility, the Federal Reserve has expanded access to all SBA-qualified lenders of the program.

The Federal Reserve also established the Main Street Lending Program to support lending to small and mid-sized for-profit businesses and nonprofit organizations that were in sound financial condition before the onset of COVID-19. Small businesses in particular are generally dependent on bank lending for credit because they are too small to raise capital in bond markets directly. The Main Street Lending Program consists of five different facilities—the Main Street New Loan Facility, Main Street Expanded Loan Facility, Main Street Priority Loan Facility, Nonprofit Organization New Loan Facility, and Nonprofit Organization Expanded Loan Facility. Loans issued under the program are recourse loans and have a 5-year maturity, deferral of principal payments for 2 years, and deferral of interest payments for 1 year. Additionally, the minimum loan amount for most Main Street facilities is \$100,000.⁴⁹

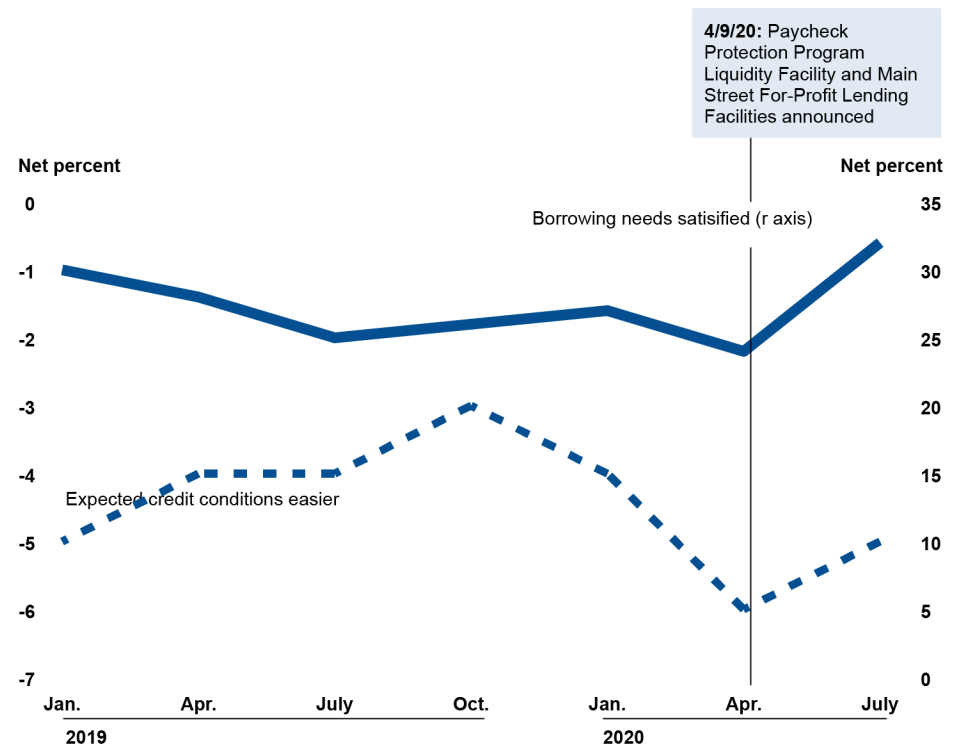
Small business owners, however, continue to expect unfavorable credit conditions. According to quarterly surveys of small and independent business owners conducted by the National Federation of Independent Businesses, in July 2020, small business owners expected credit conditions would be unfavorable in the next 3 months (that is, in the third quarter of 2020). Specifically, although expectations improved from the previous quarter, there were more owners reporting it would be harder to obtain credit than those reporting it would be easier (see fig. 11). However, the number of owners reporting their borrowing needs were

⁴⁸The Paycheck Protection Program closed to new applicants on August 8, 2020, and as of that date, lenders had made over 5.2 million loans totaling more than \$525 billion. The CARES Act and the Paycheck Protection Program and Health Care Enhancement Act appropriated a total of \$670 billion for PPP under SBA's largest guaranteed loan program, its 7(a) small business lending program. PPP loans, made by lenders but guaranteed 100 percent by SBA, are low interest (1 percent) and fully forgivable if certain conditions are met, such as using a minimum percentage of the loan forgiveness amount for payroll costs.

⁴⁹On October 30, 2020, the Federal Reserve lowered the minimum loan amount for most Main Street facilities from \$250,000 to \$100,000. The Main Street Expanded Loan Facility and Nonprofit Organization Expanded Loan Facility have a minimum loan requirement of \$10 million.

satisfied in the previous 3 months compared to those reporting they were not met increased from the first to second quarter of 2020.

Figure 11: Small Businesses' Views on Credit Conditions, January 2019–July 2020



Source: GAO analysis of data from National Federation of Independent Business. The data are copyright of the NFIB Research Center. © NFIB Research Center. ISBS#0940791-24-2, NFIB Small Business Economic Trends, William C. Dunkelberg and Holly Wade, July 2020. | GAO-21-180

Note: Data are based on quarterly surveys of a sample of the National Federation of Independent Business' membership. Borrowing needs satisfied reflects the net percent ("satisfied" minus "not satisfied") of borrowers in the last 3 months. Expected credit conditions reflects the net percent ("easier" minus "harder") of borrowers during the next 3 months. For information on the number of owners surveyed, see William C. Dunkelberg and Holly Wade, NFIB Small Business Economic Trends, Quarterly Report (July 2020). The Main Street for-profit lending facilities consist of the Main Street New Loan Facility, the Main Street Expanded Loan Facility, and the Main Street Priority Loan Facility (which was announced on April 30, 2020).

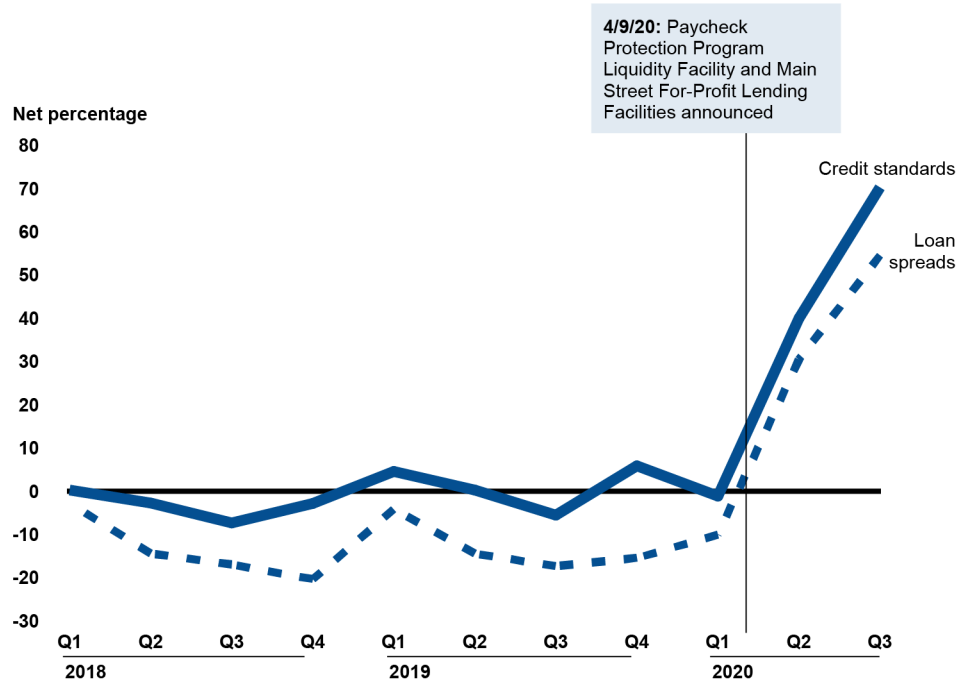
Bank underwriting standards have also tightened. Underwriting standards on small business loans measure the selectivity of lenders in determining to which small business borrowers they should extend credit. Changes in these underwriting standards over time can provide a general indication of changes in credit conditions facing small business borrowers. Underwriting standards tighten as perceived economic risk increases—

that is, lenders focus on high-quality borrowers as the economy weakens—and loosen as perceived economic risk falls.

Based on responses to the Federal Reserve's Senior Loan Officer Opinion Survey for the third quarter of 2020, banks have tightened their credit standards and terms on commercial and industrial loans to small businesses (see fig. 12).⁵⁰ According to the survey, banks cited a less favorable or more uncertain economic outlook, worsening industry-specific problems, and reduced tolerance for risks as reasons for tightening lending standards or terms. Additionally, banks continued to increase spreads of loan rates over banks' costs of funds. Increased loan spreads indicate that banks are instituting a larger difference between the interest rates they charge on loans and the interest rate paid to depositors on financial products, such as savings accounts.

⁵⁰In this survey, small businesses are defined as those with annual sales of less than \$50 million. Based on the timing of survey completion, each quarter of the survey generally corresponds to the previous quarter. For example, the third quarter of 2020 of the survey generally corresponds to the second quarter of 2020. The latest survey covers the previous 3 months, which generally corresponds to the second quarter of 2020. Respondent banks received the survey on June 22, 2020, and responses were due by July 2, 2020.

Figure 12: Banks' Lending Conditions for Small Business Loans: First Quarter 2018–Third Quarter 2020



Source: GAO analysis of Board of Governors of the Federal Reserve System data. | GAO-21-180

Note: We report results from the Federal Reserve's Senior Loan Officer Opinion Survey measured as the "net percentage" of banks tightening underwriting standards on commercial and industrial loans—that is, the percent of banks reporting that they have tightened standards minus the percent of banks reporting that they have loosened standards. A positive number indicates that more banks are tightening rather than loosening standards. Similarly, loan spreads also reflect the "net percentage" of banks increasing spreads of loan rates over banks' cost of funds. Based on the timing of survey completion, each quarter of the survey generally corresponds to the past quarter. For example, the third quarter of 2020 of the survey corresponds to the second quarter of 2020. For information on the number of respondent banks surveyed, see <https://www.federalreserve.gov/data/sloos/sloos-202007.htm>, accessed August 3, 2020. The Main Street for-profit lending facilities consist of the Main Street New Loan Facility, the Main Street Expanded Loan Facility, and the Main Street Priority Loan Facility (which was announced on April 30, 2020).

Additionally, the Federal Reserve Bank of Kansas City's Small Business Lending Survey, which contains quantitative and qualitative information on credit market conditions for bank lending to small businesses, showed similar trends.⁵¹ According to the survey's September 2020 release, 48 percent of respondents reported a change in credit standards in the

⁵¹The Small Business Lending Survey is a survey of domestically chartered commercial banks. For this survey, a small business loan is defined as a loan made to a firm with \$5 million or less in annual gross revenue.

second quarter of 2020, up about 23 percentage points from the first quarter. Of banks indicating a change in credit standards, 44 percent on net—the percent of banks reporting that they have tightened credit standards minus the percent of banks reporting that they have loosened credit standards—reported tightening their credit standards, an increase of about 26 percentage points from the previous quarter. Additionally, respondents indicated that collateral requirements increased, especially the use of interest rate floors and loan covenants. Respondents who reported tightening credit standards or loan terms in the second quarter cited a less favorable or more uncertain economic outlook and worsening industry specific problems. Lastly, according to the survey, outstanding balances on small business commercial and industrial loans increased significantly—about 70 percent in the second quarter of 2020 compared to the same quarter of the previous year—driven primarily by loans related to SBA’s Paycheck Protection Program.

Participation in the Main Street Facilities Serving Small and Mid-Sized Businesses Has Been Relatively Limited

As of November 15, 2020, the Main Street lending facilities had conducted a total of 522 transactions resulting in about \$5 billion in transaction volume, or almost 1 percent of the \$600 billion of loans that the facility’s special purpose vehicle can purchase (see table 6). Of the five facilities, the Main Street Priority Loan Facility had conducted the most transaction volume—about \$3 billion in loans through 292 transactions.

Table 6: Number of Transactions and Transaction Volume for Main Street Facilities, as of November 15, 2020

Facility	Number of transactions	Transaction volume (\$ in millions)
Main Street Expanded Loan Facility	12	902.9
Main Street New Loan Facility	216	1,007.0
Main Street Priority Loan Facility	292	3,057.7
Nonprofit Organization New Loan Facility	2	4.7
Nonprofit Organization Expanded Loan Facility	0	0
Total	522	4,972.3

Source: GAO presentation of Board of Governors of the Federal Reserve System data | GAO-21-180

According to officials from industry associations representing small businesses and community banks we interviewed, there are several reasons for the limited participation in Main Street Facilities. For example:

-
- The price of obtaining a loan through the Main Street facilities—an adjustable rate of the London Interbank Offered Rate (1 or 3 months) plus 300 basis points (or 3 percent)—may be too high compared to other loan options in the private market.
 - The 5-year repayment period may deter small businesses since small businesses may face great uncertainty from the pandemic and may be unsure if they can repay the loan within that time. SBA's Economic Injury Disaster Loan program, for example, has a repayment period of up to 30 years.⁵²
 - Small businesses with existing debt may not be willing to take on a loan, particularly with such terms.
 - The minimum Main Street loan amount, which until October 30, 2020, was \$250,000, may have been too high for many of the smaller businesses eligible for Main Street loans.⁵³

Officials from these associations and another association representing banks of all sizes stated that the complexity of the Main Street loans may also serve as a deterrent to both borrowers and lenders. For example, they stated that factors such as the complexity of the terms of the program and the number of documents and requirements associated with the loan process may discourage both small businesses and lenders from participating. As of November 24, 2020, there were 623 registered lenders under the Main Street program. Officials from associations representing banks told us that the requirement for banks to retain 5 percent of the loan may result in more costs than benefits to the banks, as banks have to account for the 5 percent and conduct their own due diligence on the loan. They also explained that they have seen limited interest from their members in participating in the Main Street facilities. Lastly, one association representing businesses of all sizes told us that restrictions on dividends and stock repurchase tied to Main Street loans may also deter some of the larger small businesses and mid-sized

⁵²SBA's Economic Injury Disaster Loan program provides economic relief to small businesses and nonprofit organizations that are experiencing a temporary loss of revenue. The purpose of the loan is to meet financial obligations and operating expenses that could have been met had a disaster not occurred. The program provides low-interest loans of generally up to \$2 million for such expenses with a maturity of 30 years. Collateral is required for loans over \$25,000.

⁵³On October 30, 2020, the Federal Reserve lowered the minimum loan amount for certain Main Street loans from \$250,000 to \$100,000.

businesses from using the Main Street facilities.⁵⁴ Data on the number of Main Street loan applications submitted that have been declined by lenders are not available to help determine the demand for Main Street loans.

According to Federal Reserve officials, the relatively limited demand for the Main Street facilities is tied to improvements in the functioning of the markets that the facilities are intended to serve, among other factors. For example, businesses may have been able to meet credit needs in the early stages of the pandemic by borrowing in the private-sector market or through the PPP. The Federal Reserve's Paycheck Protection Program Liquidity Facility has seen substantial participation, conducting more than 14,000 transactions totaling over \$100 billion, as of November 15, 2020. The officials also said lenders may not be comfortable extending loans to smaller borrowers with higher risk, especially given the need to tailor those loans to meet the borrowers' needs and manage risk. Further, they added that Main Street loans' documentation and reporting requirements—especially those related to loan participation programs and the risk management of the special purpose vehicle purchasing the loans—may create significant burdens for smaller borrowers.

Lastly, Federal Reserve officials told us that participation levels in the Main Street lending program depend on the course of the economy, whether a loan (which must be repaid, unlike a grant) is best for a specific borrower, and on the ability of lenders to meet credit needs of eligible borrowers outside of the program. They explained that the program's success is tied to the ability of creditworthy businesses to obtain credit from a range of sources, not by uptake from the facility itself. Federal Reserve officials stated that since the Main Street facilities are intended to provide financing where it is not otherwise available, they would expect growing demand for Main Street loans if the economy declines.

Recent survey data suggest that small businesses continue to be affected by COVID-19 and some expect to obtain financing or additional capital. According to the U.S. Census Bureau's Small Business Pulse Survey, for data collected through October 12, 2020, 75 percent of small business respondents reported that COVID-19 has had a large or moderate

⁵⁴For Main Street loans, an eligible borrower must commit to follow compensation, stock repurchase, and capital distribution restrictions that apply to direct loan programs under section 4003(c)(3)(A)(ii) of the CARES Act.

negative effect on them.⁵⁵ Additionally, 23 percent anticipated obtaining financial assistance or additional capital in the next 6 months, and nearly half of respondents expected that it would take more than 6 months before their business returned to its normal level of operations compared to a year earlier. In terms of assistance, more than 70 percent of respondents had already requested assistance through the PPP, 25 percent had requested assistance through SBA's Economic Injury Disaster Loan program, and less than 1 percent had requested assistance through the Main Street lending program. These businesses would be even less likely to be able to seek assistance through the Main Street lending program if their creditworthiness declines.

Most CARES Act Funds to Support Federal Reserve Facilities Were Not Used, and Treasury Has Requested Return of the Unused Funds It Invested

As of November 15, 2020, of the \$454 billion available under the CARES Act to support the Federal Reserve facilities, Treasury had committed \$195 billion and had disbursed \$102.5 billion of the committed amounts to the facilities. As of the same date, the CARES Act facilities had used about \$24 billion of the \$1.95 trillion the Federal Reserve can support in lending for these facilities.

On November 19, 2020, the Secretary of the Treasury issued a letter to the Chair of the Federal Reserve Board stating that his understanding of the congressional intent related to the facilities' authority to purchase new assets or make new loans was for all of the CARES Act facilities to stop purchasing eligible assets or extending credit on December 31, 2020.⁵⁶ In the letter, the Secretary stated that "while portions of the economy are still severely impacted and in need of additional fiscal support, financial conditions have responded and the use of these facilities has been limited." The letter cited improvements in conditions in certain markets targeted by some of the facilities and stated that banks currently have the lending capacity to meet the borrowing needs of their corporate,

⁵⁵The Small Business Pulse Survey measures the effect of changing business conditions during COVID-19 on small businesses in the United States. The weekly survey includes information on small business operations and finances, requests and receipt of assistance, and measures of overall well-being and expectations for recovery. The target population is all nonfarm, single-location employer businesses with between one and 499 employees and receipts of \$1,000 or more in the 50 states, the District of Columbia, and Puerto Rico. The margin of error for responses we included in this report was 1 percent or less, and the response rate was between 19 and 31 percent, depending on the state or territory.

⁵⁶See <https://home.treasury.gov/news/press-releases/sm1190>, accessed November 20, 2020.

municipal, and nonprofit customers. The letter also requested that the Federal Reserve return the unused CARES Act funds to Treasury.

In a statement provided to the press on November 19, 2020, the Federal Reserve stated that it “would prefer that the full suite of emergency facilities established during the coronavirus pandemic continue to serve their important role as a backstop for our still-strained and vulnerable economy.” On November 20, 2020, the Federal Reserve issued a letter to the Secretary of the Treasury stating that it would work with Treasury on returning the unused portions of the CARES Act funds. We will continue to monitor the use of the CARES Act facilities through the end of 2020, and the repayment of facilities’ outstanding loans and investments.

Agency Comments

We provided a draft of this report to the Federal Reserve and Treasury for review and comment. The agencies provided technical comments, which we incorporated as appropriate.

We are sending copies of this report to the appropriate congressional committees, the Chair of the Board of Governors of the Federal Reserve System, and the Secretary of the Treasury. This report will also be available at no charge on our website at <http://www.gao.gov>.

Should you or your staff have questions concerning this report, please contact me at (202) 512-8678 or clementsm@gao.gov. Contact points for our Offices of Congressional Relations and Public Affairs may be found on the last page of this report. Key contributors to this report are listed in appendix II.



Michael E. Clements
Director, Financial Markets and Community Investment

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Appendix I: Objectives, Scope, and Methodology

Our objectives in this report were to examine (1) steps the Board of Governors of the Federal Reserve System (Federal Reserve) and the Department of the Treasury (Treasury) have taken to design, implement, monitor, and oversee lending facilities established in response to the COVID-19 pandemic; (2) what available evidence suggests regarding the effects of the Federal Reserve's facilities on corporate credit and related markets, and levels of participation in the facilities intended to support them; (3) what available evidence suggests regarding the effects of the Federal Reserve's facilities on states and municipalities, and levels of participation in the facility intended to support them; (4) what available evidence suggests about the effects of the Federal Reserve's facilities on small businesses, and levels of participation in the facilities intended to support them; and (5) the status of CARES Act funding available to support the Federal Reserve's facilities.

To address our first objective, we reviewed Federal Reserve and Treasury documentation on the design and implementation of the facilities, such as the term sheets, application documents, frequently asked questions, public comments, and publicly available announcements and press releases for each facility. We also reviewed documentation related to scenario-based analyses the Federal Reserve conducted in determining how the lending terms and eligibility requirements would affect the funding needs of its facilities, including support from Treasury. Additionally, we reviewed the Federal Reserve's reports to Congress on the status, operations, and transaction amounts for each facility, as well as data on participants using the facilities.¹ To examine the Federal Reserve's oversight and monitoring efforts, we reviewed the Federal Reserve's Division of Reserve Bank Operations and Payment Systems documentation of its (1) framework and approach to its oversight of the facilities, and (2) completed reviews of the facilities.

To address our second, third, and fourth objectives, we reviewed research from academics, regulatory agencies, and industry experts, and analyzed the most recently available data on indicators of credit markets affected by the facilities. To identify and select potential indicators, we reviewed several sources, including prior and ongoing GAO work, federal regulatory agencies' reports and data, data available from the Bloomberg

¹Section 13(3) of the Federal Reserve Act requires the Federal Reserve to provide periodic reports on its emergency lending facilities to Congress. In addition to the required reporting, the Federal Reserve Board publishes weekly reports (also known as H.4.1) on the aggregate balance of each of the facilities and, where relevant, provides additional information about their net portfolio holdings.

Terminal and the Securities Industry and Financial Markets Association, and data on small business owners from the National Federation of Independent Businesses. We took a number of steps to assess the reliability of the data sources and indicators, including reviewing relevant documentation, reviewing prior GAO work, and interviewing data providers. We found that, collectively, the indicators were sufficiently reliable for the purposes of providing a general sense of how credit markets are performing.

We also reviewed the U.S. Census Bureau's weekly Small Business Pulse Survey to better assess the impact of the pandemic on the operations and finances of small businesses.² Additionally, we reviewed relevant research publications from academics, regulatory agencies, and industry experts and a study from the Proceedings of the National Academy of Sciences of the United States of America based on more than 5,800 small businesses that are members of Alignable, a network of 4.6 million small businesses.³

We documented changes in the conditions of credit markets and areas targeted by the facilities by assessing indicators of the price (such as credit spreads) and availability of credit (such as issuances of securities). The facilities could affect specific credit markets through the announcements of the facilities and purchases of securities or loans, as well as being intended as a backstop. However, it is difficult to isolate the effect of the facilities from other federal support. To describe levels of participation and the transaction volume for specific Federal Reserve facilities, we obtained the number of transactions and total dollar amounts from the Federal Reserve for the facilities.

To address our fifth objective, we reviewed Federal Reserve and Treasury documentation on CARES Act-appropriated amounts in support

²The Small Business Pulse Survey measures the effect of changing business conditions during COVID-19 on small businesses in the United States. The weekly survey includes information on small business operations and finances, requests and receipt of assistance, and measures of overall well-being and expectations for recovery. The target population is all nonfarm, single-location employer businesses with between one and 499 employees and receipts of \$1,000 or more in the 50 states, the District of Columbia, and Puerto Rico. See <https://portal.census.gov/pulse/data/>, accessed November 4, 2020.

³See Alexander W. Bartik et al., "The Impact of COVID-19 on Small Business Outcomes and Expectations," *Proceedings of the National Academy of Sciences of the United States of America*, vol. 117, no. 30 (July 28, 2020). The survey was conducted from March 28 through April 4, 2020.

of the Federal Reserve's facilities, including amounts allocated to the facilities.

For all objectives, we interviewed Federal Reserve and Treasury officials and representatives from associations representing banks, credit unions, small businesses, and states and municipalities, and representatives from a credit market research firm. We also reviewed relevant federal laws and regulations, proposed legislation, and a relevant GAO report.⁴

We conducted this performance audit from March 2020 to December 2020 in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives.

⁴See GAO, *Federal Reserve System: Opportunities Exist to Strengthen Policies and Processes for Managing Emergency Assistance*, [GAO-11-696](#) (Washington, D.C.: July 21, 2011).

Appendix II: GAO Contact and Staff Acknowledgments

GAO Contact

Michael E. Clements, clementsm@gao.gov, 202-512-8678

Staff Acknowledgments

In addition to the contact named above, Karen Tremba (Assistant Director), Tarek Mahmassani (Analyst in Charge), John Karikari, Richard Ryan Guthrie, Kun-Fang Lee, Loren Lipsey, Joshua Marcus, Jessica Sandler, Jennifer Schwartz, Jena Sinkfield, and Farrah Stone made key contributions to this report.

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