

Second Report of the Congressional Oversight Commission on the Use of CARES Act Funds

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Original post [here](#).

This post provides an overview of the findings contained in the Commission’s second report - click [here](#) to access the full report.

On June 18, the Congressional Oversight Commission published its [second report](#) on the [programs the Federal Reserve has established under its CARES Act authorities with equity investments from the Treasury](#).

The Commission is charged with overseeing the implementation of Title IV, Subtitle A of the US Coronavirus Aid, Relief, and Economic Security (CARES) Act (subtitled the Coronavirus Economic Stabilization Act (CESA)). CESA includes \$454 billion for the Treasury to support Fed emergency lending programs. It also includes up to \$46 billion for direct lending to the aviation industry and businesses critical to national security.

In its second report, the Commission updated the status of the programs under its purview; however, the bulk of this report is focused on sharing recent answers provided by the Fed and Treasury to the Commission’s first round of questions. Between its first and second report, on May 29, the Commission sent the agencies a list of “Tier 1” and “Tier 2” questions—with the more general Tier 1 questions to be answered by June 8 and the latter group of questions, June 29. (The list of questions can be found [in Appendix A of the report](#).)

The Commission is to publish regular reports on the use of CESA funds and is also required to report to the Congress every 30 days regarding effectiveness and other specified issues. See this [YPFS blogpost](#) for further discussion of the Committee composition and mission.

Status of Programs

On April 9, the Treasury announced its intention to use available funds under CESA to make equity investments in special purpose vehicles established under Fed lending programs. The Treasury has pledged \$195 billion of the \$454 billion available as follows: \$75 billion for the Main Street Lending Program (Main Street), \$35 billion for the Municipal Liquidity Facility (MLF), \$50 billion for the Primary Market Corporate Credit Facility (PMCCF), \$25 billion for the Secondary Market Corporate Credit Facility (SMCCF), and \$10 billion for the Term Asset-Backed Securities Loan Facility (TALF).

As of June 10, the Treasury had invested:

\$37.5 billion of the \$75 billion equity investment committed for the Corporate Credit Facility LLC, the SPV established by the Fed for the PMCCF and SMCCF

\$17.5 billion of the \$35 billion equity investment committed to the MLF

\$37.5 billion of the \$75 billion equity investment committed to the three Main Street facilities.

Between the May and June reports, only one of the facilities—the MLF—was stood up, the SMCCF having already been active by the May report. As of June 10, the SMCCF had made \$5.5 billion in corporate bond ETF purchases. The MLF had purchased \$1.2 billion of assets, solely from the State of Illinois. ([See this YPFS post for the most updated status of Fed lending programs.](#))

As of the June 18 publication date, the Fed had established six facilities with equity from the Treasury. Four of these facilities were then operational: the two mentioned above and two additional facilities—the Money Market Mutual Fund Liquidity Facility (MMLF) and Commercial Paper Funding Facility (CPFF)—that received their Treasury funding from the Exchange Stabilization Fund (ESF), not CARES Act funds, and thus are outside the purview of the Commission.

The report notes that no loans have been made from the \$46 billion allocated under Subtitle A for the airline industry and firms essential to national security. However, several airlines have made public proclamations regarding their expected use of these programs.

Without commenting directly on its new inclusion under the Commission’s umbrella, the report does mention the TALF. As originally conceived, the TALF was to receive its equity investment from the ESF, but this was changed with the Fed’s May 12 [update](#) of the TALF term sheet: the TALF was instead to be capitalized by CARES Act funds. While the TALF was not included in the Commission’s May 18 report, the Commission has pulled the facility into its orbit—though, as noted, the program is not yet lending.

The Commission noted that the announcement effect from these Fed facilities seems to have been robust—pointing to a strong stock market rally in recent months and the record-breaking debt issuance by both investment-grade and high-yield firms. However, at many points in the report, the Commission—[mandated to answer the question of who is being helped by the disbursement of CESA funds](#)—also expressed skepticism over this market boon’s inclusiveness, noting that middle-market firms without access to the bond market are likely being left behind and that even firms with credit access are not necessarily maintaining their workforce and payroll.

Broad Concerns: Too Lax

The Commission’s questions and its discussion of the agencies’ answers are a good indication of how it views its oversight mandate and mission. Major concerns raised included: the interrelationship of Fed lending programs with employment concerns, the integrity of the lending process, consistency across various government programs, and alignment of the administration with the Act’s terms.

In evaluating the agencies’ responses to the Commission’s Tier 1 questions, the oversight body noted that some firms are taking advantage of the newfound calm in the bond market only to lay off workers after a successful debt issuance—and sometimes even continue paying dividends. The Commission noted that the facilities for medium-sized firms—the three Main Street lending facilities—have yet to be made operational. The report additionally probed why the agencies opted to [design the Main Street facilities to operate through banks](#), as opposed to creating a direct lending facility as the Act suggested, but did not mandate.

Further, the Commission noted that none of the facilities require that recipients maintain their workforce in the manner of the [Paycheck Protection Program](#), a \$650 billion program to provide forgivable loans to small businesses if they retain or rehire employees. The PPP is administered by the Treasury and the Small Business Administration. The strictest provisions in this regard come only with the Main Street facilities and simply require recipients to make “commercially reasonable efforts” to maintain payroll.

Furthermore, the agencies indicated a limited focus on employment impact in their response to the Commission’s probing on this definition: the agencies will not monitor firms’ adherence to this stipulation and will only evaluate it at a macro level. That is, they will monitor whether commercially reasonable efforts were made via observing the status of “the economic recovery and employment broadly rather than on a borrower-by-borrower basis.”

The report also expressed concern that, as updated, the [Main Street facilities](#) no longer require that the end-borrowers attest to needing financing “due to the exigent circumstances presented by the coronavirus.” While the Commission acknowledges that the COVID-19 emergency has greatly impacted the entire economy, it also expressed concern that, at the micro-level, many firms who are not in need of emergency financing will still seek it—stoking an inconsistency with the CARES Act’s discussion of these facilities being for eligible borrowers in need due to “losses incurred as a result of the coronavirus.”

The Commission is similarly concerned about the value of the [SMCCF](#). Given the record issuance levels of corporate debt and historically low yields in the bond market, the Commission argued that the SMCCF might not need to make purchases, or at least not at the rate it currently is. After all, the stated purpose of the facility is to restore

functioning to the corporate bond market. The Commission asked the agencies for clarity on the distinction between a functioning and non-functioning corporate bond market and questioned [why the PMCCF is not itself sufficient](#). Furthermore, it reminded the agencies that the Fed’s Section 13(3) emergency lending authorities require the presence of “unusual and exigent circumstances.” “The COVID-19 crisis clearly created such circumstances,” the Commission noted. “However, it is important that the Federal Reserve’s use of these emergency powers not extend for a longer period of time than is necessary.”

Broad Concerns: Too Strict

Nonetheless, the Commission also expressed the concern that some of the restrictions placed on the facilities are too strict. It noted that Treasury has allocated less than half of the \$454 billion available to capitalize Fed facilities, three months after the passage of CARES.

For starters, the Commission noted the cliff effects associated with the terms of the PMCCF—namely, that it is reserved for investment-grade borrowers or those who were as of March 22 and haven’t fallen further than a BB- credit rating—a date chosen by the agencies to coincide with the last day before the program was announced. In their responses, the agencies noted that there can be steep rises in borrowing costs associated with even a single downgrade—which can put pressure on firm’s employment and output.

The report points the agencies in two possible directions to support expanding these purchases to a wider group of recipients. First, the agencies could use more of the Subtitle A funds for capitalization of the PMCCF (or simply allocate more of the equity already in the SPV to each purchase), thus maintaining the requisite level of security for Fed emergency lending while still being able to move down the risk scale.

Secondly, the Commission points to the agencies’ own words justifying the purchase of sub-investment-grade ETFs with the SMCCF in which the agencies note that the “increased risk associated with acquiring instruments issued by high-yield companies is managed by investing through instruments that allow for the creation of a diversified portfolio;” that this logic is not evenly applied to the PMCCF left the Commission to question high-yield bonds’ exclusion from the primary market facility.

Similarly, the report noted that the leverage requirements built into the Main Street facilities may be too exclusive or, at the least, not fit for their intended purpose. It is especially critical of the discrepancy between the leverage restrictions of the two new-loan facilities: the Main Street New Loan Facility—which allows borrower leverage of 4x adjusted earnings—and the Main Street Priority Loan Facility—which allows new loans to borrowers with leverage of up to 6x adjusted earnings. The agencies responded to the observation of the former’s stricter terms by noting that the latter requires 15% loan

retention by the lender while the former only requires 5% retention. However, the agencies had changed these terms on June 8; both facilities now only require 5% lender retention. The agencies themselves noted this update to the facility's terms elsewhere in their responses, so their use of the dated higher retention requirement for this particular answer was incongruous, leading the Commission to respond to this answer by pointing out the agencies' justification was inconsistent.

The Commission also more generally encouraged the agencies to expand access to the Main Street facilities (such as by lowering minimum loan requirements—currently \$250,000 for new loans and \$10 million for expanded loans) and the MLF (such as by easing the terms to the point of U.S. territories being eligible).

Other concerns

The Commission noted some other broad concerns but framed them more as yet-to-be-answered questions. Concerns included a desire for more background information on how certain cutoffs were determined in program designs—e.g., that the PMCCF can only purchase up to 25% of an issuance if participating alongside other investors. The Commission also questioned justifications for deferrals to specific outside groups, such as the group of credit rating agencies whose ratings are accepted by the Fed, and the use of BlackRock to manage the CCFs—with a questionable information barrier between its duties to the Fed/public and its other business activities. As the Commission noted, some BlackRock executives are “permitted to provide ‘investment management, trading or advisory services’ in any asset class and to purchase investments for themselves in any asset class after a two-week cooling-off period.”

The Commission's “Tier 2” questions, which it requested be answered by June 29, generally hew to the themes discussed above, continuing to probe for justifications of specific stipulations and cutoffs built into the design of the program and better data points to monitor program efficacy and compliance. It is expected to address the agency's Tier 2 responses in its next report.

Per the Act, the Commission is composed of five members, four members appointed by the leaders of the House and Senate and a chairman jointly appointed by the speaker of the House and the Senate majority leader, after consultation with minority leaders. As of today, the chairman position remains unfilled.