

Senate Bill Temporarily Restores Treasury, FDIC Guarantee Authority Eliminated Post-GFC

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Original post [here](#).

The coronavirus [rescue bill](#) that the US Senate passed unanimously on March 25 temporarily restores the ability of the Treasury Department and the Federal Deposit Insurance Corporation (FDIC) to guarantee money funds, transaction accounts, and senior bank debt, a reversal of the elimination of these authorities by Congress following the Global Financial Crisis (GFC).

Treasury Guarantees of Money Funds

During the GFC, Treasury responded to a run on money market mutual funds by introducing a temporary guarantee on such funds' existing balances on September 19, 2008. This Temporary Guarantee Program for Money Market Funds (the focus of a [YPFS case study](#)) relied on the [Exchange Stabilization Fund \(ESF\)](#) for funding because Treasury did not believe it would be able to secure timely approval for the program from Congress. Established pursuant to the Gold Reserve Act of 1934, the ESF's mandate as amended in the 1970s is to ensure "orderly exchange arrangements and an orderly system of exchange rates." In pursuit of this goal, the Treasury Secretary, with approval from the President, "may deal in gold, foreign exchange, and other instruments of credit and securities." Treasury previously used this authority to respond to a financial crisis without congressional approval in providing a [\\$20 billion support package](#) to the Mexican government during the 1994-1995 peso crisis.

The Temporary Guarantee Program expired on September 18, 2009. No claims were ever made against the guarantee, and Treasury generated \$1.2 billion in participation fees. Prior to this expiration date, Congress specifically prohibited the Treasury Secretary from using the ESF "for the establishment of any future guaranty programs for the United States money market mutual fund industry" as part of the [legislation establishing the Troubled Asset Relief Program](#). This prohibition was part of the backlash against crisis rescues and reflected Congress's desire to approve future guarantees.

Money market mutual fund redemptions have reemerged during the current pandemic and affected the liquidity of their sponsors. For example, Goldman Sachs [announced](#) on March 23 that its banking subsidiary had injected \$1.8 billion into two sponsored funds the previous week. Investors withdrew [\\$8 billion](#) from those funds between March 11 and 20, representing one-third of their assets as of [February 29](#).

To stem redemptions in the money market, the US is reintroducing versions of GFC-era programs. On March 18, the Federal Reserve announced the [Money Market Mutual Fund Liquidity Facility](#) to lend funds to financial institutions to purchase assets from money funds. On

the same day, Treasury proposed [establishing another temporary guarantee](#) on money fund balances.

To lay the groundwork for such a program, the Senate’s rescue bill would temporarily allow the Treasury Secretary to use the ESF to guarantee money funds. Under Section 4015(a) of the bill, this authority will end on December 31, 2020. Any guarantee programs established pursuant to this temporary authority must expire by this date and be limited to fund balances in place prior to the programs’ announcement. This latter requirement mirrors a provision in the GFC-era Temporary Guarantee Program that had been designed to prevent runs elsewhere in the financial system. If only balances in place prior to a program’s announcement are guaranteed, there is no incentive post-announcement to transfer funds from non-guaranteed accounts to newly guaranteed money funds.

Section 4015(b) of the Senate bill would provide that Treasury shall reimburse the ESF for any losses it sustains from the program.

FDIC Guarantees of Transaction Accounts and Senior Debt

The FDIC also made use of guarantees during the GFC. In October 2008, the FDIC adopted the two-pronged Temporary Liquidity Guarantee Program (TLGP) as part of its response to continued deterioration in credit markets following Lehman Brothers’ bankruptcy. Under the Debt Guarantee Program prong (the focus of a [YPFS case study](#)), the FDIC fully guaranteed senior unsecured debt issued by eligible financial institutions. Under the [Transaction Account Guarantee Program](#) prong, the FDIC fully guaranteed all domestic noninterest-bearing transaction deposits at participating financial institutions.

The legal authority for the TLGP came from the Federal Deposit Insurance Corporation Improvement Act of 1991. Pursuant to this Act, the FDIC is typically required to provide assistance to troubled insured depository institutions in a way that minimizes the cost to the Deposit Insurance Fund. However, there is a “systemic risk exception” which allows the FDIC to deviate from this approach if following it “would have serious adverse effects on economic conditions or financial stability” and overlooking it “would avoid or mitigate such adverse effects.” The decision to invoke the systemic risk exception is made by the Treasury Secretary in consultation with the President, following a written recommendation by a two-thirds majority of both the FDIC Board of Directors and the Federal Reserve Board. On October 13, 2008, Treasury Secretary Hank Paulson invoked the systemic risk exception following this procedure to establish the TLGP.

Having guaranteed almost \$350 billion in senior bank debt at its peak, the Debt Guarantee Program saw its last guarantee expire on December 31, 2012. The program generated over \$10 billion in fees and experienced less than \$200 million in claims.

The Transaction Account Guarantee Program expired on December 31, 2010 and suffered about \$1.5 billion in cumulative losses.

Post-crisis there has been significant questioning of the propriety of invoking the systemic risk exception for the TLGP. Specifically, it is arguably unclear whether the authorizing legislation allows an exception to be declared based on a threat to financial stability from the banking system as a whole or based just on a threat from a single institution. There are also questions about what FDIC procedures must be followed once the exception is invoked. As required by law, in 2010 the [GAO reviewed the systemic risk exception determination](#) for the TLGP and found that while there is “some support” for the interpretations on which it relies, the interpretations are subject to question. The GAO recommended that the statutory requirements be clarified given the significance of the issues involved.

In the Dodd-Frank Act, Congress significantly restricted the ability of the FDIC to establish a program like the TLGP in future. While something like the Debt Guarantee Program is still possible upon a “liquidity event determination” similar in procedure to the systemic risk exception, under the Dodd-Frank Act such a program requires congressional approval. Programs like the Transaction Account Guarantee Program, meanwhile, are specifically prohibited by Dodd-Frank.

While the current pandemic has not yet had the effect on bank funding that the GFC did, [some have argued](#) that restoring the ability of the FDIC to enact guarantee programs like the TLGP will help calm depositors and creditors who might ultimately grow skittish. The Senate bill would provide a temporary restoration of this authority. Section 4008 of the bill would eliminate Dodd-Frank’s prohibition on interventions like the Transaction Account Guarantee Program. Furthermore, Section 4008 would authorize the FDIC to establish a widely available guarantee program upon a liquidity event determination without further congressional approval, provided that such program and its guarantees expire by December 31, 2020.